BOARD MINUTES 2005

THE ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM
MEETING OF BOARD OF DIRECTORS

MINUTES
FEBRUARY 23, 2005

BOARD MEMBERS:
Ms. Kay Ivey, Chairman
Mr. Ed Sherling
Mr. Willie Huff
Dr. Harold McGee
Ms. Sarah Moore
Dr. Mike Malone
Ms. Janet George, representing Dr. Roy Johnson
Lt. Gov. Lucy Baxley (not present)
Mr. Bill Drinkard (not present)
Mr. Ricky Jones (not present)

ALSO PRESENT:
Ms. Daria Story, Assistant Treasurer
Mr. Anthony Leigh, Deputy Treasurer
Mr. Roman McLeod, College Savings Program Coordinator
Ms. Brenda Emfinger, College Savings Program Director
Mr. Mike Manasco, Treasury Legal Counsel
Mr. Bud Pellecchia, Callan Associates, PACT Consultant
Ms. Patricia Higgins, Court Reporter

Pursuant to written and public notice, a public meeting of the PACT Program was held in Room 300, RSA Union Building, 100 North Union Street, Montgomery, Alabama, on Wednesday, February 23, 2005, commencing at 11:00 a.m.

Chairman Ivey called the meeting to order and requested roll call. A quorum was present.

Chairman Ivey recognized Janet George from the Department of Postsecondary Education, who was representing Dr. Johnson, and Pat Higgins, the owner of Dunn, King & Associates, a registered professional reporters organization.

Chairman Ivey presented the minutes of the December 8, 2004, board meeting. Ms. Emfinger presented a correction to the minutes to reflect that Chairman Ivey temporarily left the meeting and Vice Chairman Ricky Jones presided. Mr. Huff made a motion to approve the minutes as amended with a second by Mr. Sherling. The motion unanimously carried.

Agenda Item III. A. (1.)
The program report was received as information.

Agenda Item III. A. (2.)
Chairman Ivey called on Bud Pellecchia for the quarterly investment report.

Mr. Pellecchia began with an update on the SEC inquiry regarding the consulting industry. A letter from Callan's chairman was sent to all clients in January. In February, the SEC did respond to Callan, asking for additional information relating to disclosure procedures with our clients. Callan viewed this as an opportunity to make them aware of the disclosures that are in place and the stopgaps we have with regard to any potential conflicts of interest. They think that nothing will come of this, that there's a very good chance they may never hear from the SEC again.

He said, I also call your attention to another recent article in the New York Times about this subject. It did not bring up anything new, but it pointed out how some public funds have done their own audits of consulting firms.

In looking at the December 31 quarterly report, I wanted to give a brief synopsis on performance of this fund since Callan has been involved and just to make a comment that absolute performance has been very good. It's been ahead of what actuarial assumptions are, but that is something that none of us can take credit for because of the fact that the markets have done so well, three, and particularly the last quarter of '04. And you will see that.

On a relative basis, we have still underperformed our benchmarks. And I think we have all collectively done a lot of work in this area to address these problems, both from due diligence, asset allocation work, and the hiring of new managers; but as you will see, we do have more work to do in making the performance turn around. But from a big picture kind of view, performance has been very good.

If you turn to the first section for a quick synopsis on the market overview during the last quarter, you'll see on page 2 that equity performance was very strong for the quarter. The S&P 500 was up over 9 percent. The non-US equity EAFE benchmark was up over 15 percent.

The equity markets were driven by three things: One, the resolution to the U.S. presidential election, falling energy prices, and expected moves by the Fed. Although there were two rate increases, it was what all investors expected; so there were no surprises, which helped the equity market.

The domestic fixed income market, despite the two rate increases, was in positive territory at 95 basis points for the quarter.

For the full year, the S&P was up over 10 percent; but just about all of that return came in the last quarter. The EAFE was up over 20 percent, and domestic fixed was four and three-quarters.

On page 3, looking at just domestic equity for the quarter, small cap managers beat large cap once again; but for at least this quarter, growth slightly beat value. Over the longer term, the four quarters ending December 31, small value was the place to be. Once again, small cap and value outperformed.

On page 4, domestic fixed income was in positive territory. The fixed income market was actually quite resilient despite the short-term rate hikes. Most managers expected rates to increase. Short-term rates certainly did with the Fed raising those rates, but the long-term rates actually stayed the same and in some cases
came down. Core bond managers for the quarter were up 1 percent, slightly ahead of the benchmark. And for the full year, core bond managers were up 4.48 percent. Even though there was Fed rate increases during the year, extended maturity managers were solid performers, up over

8 percent. And, again, that's because the longer-term rates stayed the same or came down a little bit. High yield was once again a strong place to be as spreads contracted in the high-yield market.

On page 5, international equity, for the third consecutive year, the EAFE beat the S&P 500. As I mentioned, it was up 15.32 for the quarter. More than half of the quarterly return came from the depreciating dollar. For the year, of the 20 percent return that we saw in EAFE, about 8 percent came from the depreciating dollar. All areas of the world performed well, with emerging markets once again leading the way. And 2004 marked the fourth consecutive year that emerging markets beat developed markets with strong performance there for the year of 26 percent.

On page 9, there is a snapshot look at the asset allocation as of the end of the year.

Dr. Malone asked if they had anticipated the economic effects of the tsunami, particularly in the Pacific Basin. Mr. Pellecchia responded that there would be repair work, so there would be a lot of spending going on. While consumers over there may not be the ones spending, the governments will probably do a lot of spending, and that will actually help demand. We could see positive returns from there.

Turning again to page 9, asset allocation, large cap and small cap equity were right on target. There was a slight overweight to international equity and underweight to fixed income, but there was an allocation of cash as money came in during the quarter. There was no recommendation for any asset allocation changes.

Page 10 provides a look at the performance for the quarter for the total fund and its attribution analysis, which breaks down that return. The actual return was 7.85 percent, which is a very strong absolute number for a quarter. However, the target return, had you been 100 percent invested in indexed funds at the target weight, would have produced an 8.36 percent return. There were two different effects. One was managers' performance, and the other was asset allocation. The managers detracted value by 52 basis points for the quarter. Most of that, 48 basis points, came in the large cap equity area. Five basis points was on the positive end, where we were slightly underweighted in domestic fixed income, when equities performed a lot better during the quarter. In summary, you have strong performance here for the quarter, but not as good as the benchmark.

Page 13 ranks your performance over time versus the Callan public fund sponsored database. The quarterly return ranked fairly high, in the 35th percentile. However, the longer periods, including the one-year number, were below the target and in the bottom quartile. We have addressed manager issues, but there is still work to do.

Page 15, for the quarter, there was an investment return in dollars of close to $50 million, which brings the fund to $688 million as of December 31.

Page 20 was requested by the board. There is a list of your current managers, their benchmarks, and their inception date, showing that we have made moves in addressing manager performance. You only have two really long-term managers, Sterne Agee and Rhumbline. Peregrine and AmSouth have been managers since 1999, and the rest of the managers are very recent hires. State Street and Bank of Ireland have been terminated.

Page 25 is the performance of Peregrine, the large cap growth manager. They beat their Russell 1000 growth benchmark and were ranked low median, however, in the 64th percentile. They had a significant overweight in technology, which helped performance; but most of the postelection rally was led by lower quality stocks. Their style is to invest in high quality growth companies, which means that they do not participate when those lower quality stocks take off, which is the reason they underperformed in 2003 and in the first and fourth quarter of 2004. The longer-term performance for Peregrine is better with the five-year number in the 32nd percentile. The three-year number is at least close to median. The last three years have been disappointing for Peregrine; but we still think this is a solid manager, a high quality, strong growth manager. Their style of performance has just not been in favor over the last three years. And even with that, if you look on page 26, on a year-to-year basis, the other four years were close to median or right above. If you were to replace Peregrine with the same type of manager, you would be looking at three- and five-year performance numbers; and you would have a hard time finding managers that have outperformed what Peregrine has done. Callan still feels strongly about Peregrine.

Mr. Huff asked if we are overfunded in large cap growth in that the last five years, it has underperformed small cap and why do we think that large cap growth is going to get any better going forward? Mr. Pellecchia responded, markets move in cycles and it has been a value market over the last five years, which would lead me to believe that growth is going to outperform going forward as opposed to value outperforming going forward. A historical chart would show that growth and value do move in cycles. If you recall, in the late '90s, it was all growth. In March of 2000, it sort of changed on a dime. Overall, you want a policy that is equal weighted with no bias towards growth or value. And as far as capitalization, we look at a broad benchmark, like the Russell 3000 or the Wilshire 5000, which includes all capitalization stocks. And if you break down that broad benchmark by capitalization, about 15 to 20 percent of that benchmark is small cap. And that is approximately where you are. Mr. Huff responded that he thought we had 9 percent in small cap. Mr. Pellecchia explained that 9 percent of the total fund is small cap and if you take that out of the total domestic equity, it is about 15 to 20 percent. Mr. Huff stated that he believed that just because something happened that way for the last 30 years doesn't necessarily mean it will happen again, which leads him to believe that maybe we still have too much money in the area. Mr. Pellecchia responded that they were comfortable with the amount of money in large cap growth. Mr. Huff and Mr. Pellecchia had a discussion on market timing. Mr. Huff noted that Mr. Pellecchia had answered his question satisfactorily.

Ms. Moore asked if Peregrine had any changes in management or portfolio managers during their tenure. Mr. Pellecchia responded that they had been consistent from the beginning.

Mr. Pellecchia then turned the Board's attention to page 30, the performance of Rhumbline, the index manager, replicating the Russell Top 200 stocks. He stated that Rhumbline had performed as expected, mimicking the index within a certain amount of tracking error. The performance as a comparison against active large cap core managers is an indication of where index managers have performed against active managers over time, and especially those with the largest cap.

Mr. Huff asked about the Rhumbline fees compared to Peregrine. Mr. Pellecchia stated that the Peregrine fees were higher. Mr. Huff further observed that if you look at the five-year and the three-year of Peregrine to Rhumbline, Rhumbline has outperformed, so that in effect, the computer has outperformed an active manager even though we're paying more for the underperformance. Mr. Pellecchia stated that we are paying for exposure to growth and that in a fund of this size, it pays to have a combination of passive and active, that the allocation amounts are appropriate.

Page 33 shows the relatively large cap value manager Bear Stearns. They underperformed the value index for the quarter and for the six months. As you can see, that benchmark itself was a tough bogey to beat for active managers. Bear Stearns, as we talked about on the conference call for the

Investment Committee, was hurt by insurance industry holdings, specifically, Marsh & Mclennan. Also, AIG and St. Paul Travelers came down along with it. They trimmed their position at Marsh & Mclennan, but they still think that it's an undervalued stock. They were also hurt by exposure to pharmaceutical company, Pfizer, following the news about Celebrex potentially linked to risks of cardiac problems. They are below the benchmark for the six months that you've hired them; but against the peer group, they are basically at the median, the 51st percentile. They didn't get off to a good start, but it's only been six months.

Page 36 shows Earnest Partners, a new small cap value manager hired about six months ago. We have good performance, 19 percentile for the quarter and 12th percentile for the six months, beating the 2000 value. Mr. Pellecchia continued that small cap growth, on the other hand, page 39, was very good, up over 13 percent. State Street is the manager that was hired and then had personnel changes and was terminated. They had a decent quarter coming back on an absolute basis, still trailing their benchmark.

Page 43 is the Bank of Ireland. They were basically at their benchmark, slightly below, but ranking high, as the benchmark was a difficult bogey to meet. For the quarter, up 15.24 percent. They are a manager that has a bias towards high quality, high cap stocks in the international area. What was rewarded in this time period was lower quality, small cap, emerging markets. Originally, we were looking to compliment Bank of Ireland by hiring a second manager. Ultimately, they had more problems because they lost a good amount of their portfolio managers. And so when we were in the process of that search, we decided to replace Bank of Ireland instead of complimenting them. And now we have engaged New Star, so you will see performance for New Star going forward.

Page 45 is AmSouth Asset Management, one of the fixed income managers. They underperformed for the quarter and for the last two years. They are more of a conservative oriented fixed income manager. In 2003, their underperformance was really a result of being significantly underweight in the corporate area, especially the lower quality corporates. In 2004, they added to their corporate exposure, but they were anticipating a rise in interest rates; and as such, they had a much lower duration than the benchmark. When rates did not rise in 2004, that led to their underperformance. Over longer term, three-year and the five-year number, they have good performance, 37 to 16th percentile. They are a very good compliment to the other fixed income manager, Sterne Agee, in that Sterne is much more aggressive, will hold more credit, will hold more aggressive sectors, including CMO's. However, there has been discussion about the possibility of changing the dollar allocations between the two fixed income managers.

Mr. Huff informed the Board that the Investment Committee had had a conference call on January 26th and discussed the fixed income managers, specifically, the issue of performance comparison between Sterne Agee and AmSouth, questioning whether we have the proper amount of money allocated between the two, in that Sterne Agee has always outperformed AmSouth on all the yearly schedules. The Investment Committee has asked Bud to come back to the Investment Committee with a recommendation next month. Mr. Pellecchia stated that he would be prepared to do that and that there was a better case for overweighting a portfolio to one manager versus another when you have the managers theoretically doing the same thing. It's not like a growth-value type of thing.

To close, on page 51 is the performance on Sterne. They have consistently performed very well, actually had a longer duration than benchmark during the quarter, and more exposure to corporates and mortgages. Mr. Huff asked if there had ever been a manager on the equity side, or the fixed income side, that always beat the index for every category? Ms. Moore stated that she had noted that Sterne Agee is at the top 10 percentile and everybody else is at the bottom 10 percentile in everything we're doing. Mr. Huff stated that Bud would be making a recommendation. Ms. Moore asked if that would be the Investment Committee's decision and was told that it would be with the recommendation presented to the Board.

Ms. Moore stated that the report was very disturbing and that looking at the percentiles where we've been performing and considering our funded status in our PACT program, she was very concerned. She further stated that the fund managers are just not performing very well; and even with the market, you want people to be actively managing your portfolio to do better than the indexes. And not only are we not even at par with the indexes, we're sub par. She questioned how we're going to get where we need to be with these managers. The Chairman stated that this was a point well made.

Ms. Moore stated that she saw a quote from Will Rogers one time, "This ain't no time for slow ponies," and that she thought we're riding some slow ponies. Mr. Pellecchia then directed Ms. Moore's attention to page 20 of the report to note actions of the Board taken over the last year to address these issues. Ms. Moore further stated that we have given a lot of them long enough.

Mr. Pellecchia stated that the Rhumbline portfolio is an index fund where you should expect index performance. Ms. Moore stated that she understood that one, but that if you just look at the performance of many of these managers, they're in the bottom half. She stated that if she had the luxury of sitting on a funded position of 500 percent, she wouldn't worry as much, but does worry because we're underfunded.

Mr. Pellecchia stated that he did understand and that a lot of these issues have been addressed. Fox Asset Management was a large cap value manager for a number of years with underperformance and was terminated, with Bear Stearns being hired only six months ago. The small cap manager was a firm called Citigroup, who had been slightly underperforming. They were really more hugging the benchmark, but we were paying active fees, so they were terminated and a value and a growth manager were hired. The growth manager had personnel issues, so they were terminated quickly. Earnest has done a good job for the six months. Bank of Ireland we fired. Sterne Agee has been performing well, and AmSouth over the three-year period to five-year period has been performing well. So we have addressed a lot of the manager issues. He further stated you can't just fire managers every six months. Ms. Moore stated that she realized that; but that since she had been on the Board, it was just tough to keep looking at these negative numbers, and we need to be critical of these returns. She said we will address a lot of these things in the Long Range Planning Committee meeting this afternoon to see just how much room we give people.

Dr. McGee said that he would assume in the Long Range Planning Committee that the biggest issue would be how to close the gap we've got and that this would be a part of the recommendations. Chairman Ivey intervened, saying that the Long Range Planning Committee would make some recommendations to find ways to close the gap and turn those deliberations over to the Investment Committee, so both teams could conceivably be working to find solutions to closing the gap.

Dr. Malone stated that there has been a systemic problem with the Board acting, but that they have taken some steps by engaging the Investment Committee on a regular basis to review the data. Chairman Ivey clarified, saying three to four weeks after every quarter, the Investment Committee will have those scheduled discussions.

Dr. Malone then stated that the Board needs to look at its own internal procedures and processes to make sure we're not the enemy and expressed concern about pulling the trigger maybe faster than we should. He further stated that he believed the Board, the last three years, had been very quick to look at the data and make some tough decisions concerning steps to take.

Chairman Ivey noted Ms. Moore's concern over manager returns.

Chairman Ivey called on Mr. Huff for the Investment Committee report, stating that Mr. Jones was serving as the national president of the American Wholesale Marketing Association and was attending their annual meeting.

Mr. Huff reported that the Bank of Ireland was terminated, but that it took longer than expected on the contract language with New Star. As a result, the Investment Committee agreed to have Bank of Ireland act as manager of international assets until the new contract is in place, which should be within a month. Additionally, New Star requested an amendment to our policy regarding emerging markets. Based on our discussions with Bud, the Investment Committee is recommending the approval of that amendment to allow New Star to invest up to 10 percent in emerging markets. The report was received as information.

Mr. Leigh returned from the Legislature and reported on the 529 legislation. He reported that the Education Finance and Taxation Committee unanimously approved the Senate bill out of committee this morning. The only problem is that if this bill passes the Senate, it will have to go back to the House. The ideal thing would have been to substitute the House bill, which was passed yesterday, in the Senate. Mr. Huff asked when the final legislation will be passed. Mr. Leigh responded that hopefully, it would pass in two or three weeks.

Agenda Item IV. A.

Chairman Ivey called the Board's attention to consideration of the resolution for a provider of payment processing services. A motion was made by Ms. Moore to approve Regions as provider for payment services. The motion was seconded by Mr. Huff, with unanimous approval.

Chairman Ivey noted appreciation for the staff analysis to give the Board a clear understanding.

Agenda Item IV. B.

Chairman Ivey then called on David Dahill for a presentation on securities lending. By way of information, Ms. Emfinger explained that JPMorganChase, the new custodian, had included securities lending as part of their pricing schedule and they had been asked to give the Board an overview of securities lending.

Mr. Dahill began by stating that securities lending was a low risk product that allows you to add incremental returns to your portfolio by unlocking the economic value of the securities that you hold in your portfolio. The following was his discussion:

We use our securities lending agreements to establish the risk profiles of each lender to determine what type of flexibility on the collateral management side, the approved borrowers, the different types of collateral, whether it be securities or cash, and how we can reinvest that. Our objective is to take your risk tolerances and your concerns and maximize the associated revenue that can be generated from securities lending.

So on page 1 of the presentation that we have handed out, I have put together what the overall philosophy and objective of securities lending is to kind of give you a sense of what JPMorgan will do for you in anticipation of participating in a lending program.

On page 2, we describe to you what is securities lending. It is an asset management technique in which we are lending securities out to different broker-dealers and banks in return for collateral, typically in the form of cash. The securities in demand are listed on the left-hand side here, and you see that goes from U.S. treasuries down to real estate investment trusts. Typically, you will see 80 to 100 percent of your treasuries go out on loan, whereas, your equities will only be out on loan in the range of 8 to 15 percent of the securities that you have in the lending program. We lend those securities out versus the different types of collateral, which is cash, securities, and letters of credit. We lend those out on a collateralized basis.

And when we are putting those securities out on loan for you, we are receiving collateral at 102 percent of the value of the securities that go out on loan for same currency securities. So if we are lending U.S. dollars, we take in dollars at 102 percent. If we're lending Euro securities, we take in 105 percent. The differential between the margin is associated with the foreign exchange risk associated with the nonsimilar currencies when you're lending Euro securities and taking in dollars as collateral. We then take that cash collateral that we receive from the borrowers and we reinvest it in accordance with your investment policies. We take that cash and we try and earn higher than what the Fed target rate is. So in the current interest rate environment, where the Fed policy is at two and a half percent, we're going to try and invest at something higher than that. So our benchmark is that Fed target rate. Typically, we earn 10 to 15 basis points higher than what the Fed target rate is. And then when the borrowers pledge the cash to us, they expect us to pay them a rate of return or a rebate on the value of the collateral that they have pledged. The differential between the two is the spread or the profit associated with the transaction.

So if you turn to page 3, it will show you who are the institutions that are providing the supply of securities into the market: Pension funds, insurance companies, mutual funds, endowments, foundations, even sovereign institutions, including central banks.

Mr. Huff asked what kind of securities is the cash collateral invested in to generate our profit or why we're doing this. Mr. Dahill responded that the return that you would generate is invested typically in timed deposits, repurchase agreements, medium-term notes, overnight commercial paper. There are different parameters associated with the program. And you can define what we can invest that collateral in through the contracts that we negotiate with you; but typically, our largest allocation right now in our program is in repo, which is overnight security. Mr. Huff asked what kind of spread we receive on that or how many basis points we generally are targeting. Mr. Dahill responded that it would be 10 to 15 basis points over the Fed target. Mr. Pellecchia clarified that this was on the collateral, not necessarily what we're going to make.

Ms. Moore asked whether we would be getting about 28 basis points. Mr. Dahill responded that typically, that would be what you would get on your securities that are on loan. So if you had 100 percent in treasuries, you're probably getting 28 basis points on your entire portfolio. And that varies by asset class. The most profitable securities are your international equities. There's a tax arbitrage value associated with them. As a U.S. plan, you're entitled to, say, 85 percent of the dividend. A local investor may be entitled to 100 percent of the dividend based on the tax treaties between the U.S. and the countries that you're investing in. The arbitrage value is the difference between what you're entitled to and what the local resident is entitled to. We understand that, and we can calculate that. And then we split that with the broker-dealer, and then we again split that with you as the lender of your securities. There are also other arbitrage values associated with a merger and acquisition. Typically, the acquiring company will fall in price and the acquired company will rise in price. So the broker-dealers and the banks are aware of that. So they will come in and they will borrow the company that's buying or merging, and they will short it in the market. And then when it hits a price that they feel is their acceptable level of profit, they go out and repurchase it and return it back to the bank.

Mr. Huff asked how you address the coordination issues; for example, if a money manager wants to dump a stock that we've got out on a loan. Mr. Dahill responded that it's the same way that you would handle it if you were adjusting custody and you were not lending it. There is no need for dual notifications. So the manager would inform us as your custodian that they are selling the security. What we do is we look to our broad inventory base of over $900 billion in our program to reallocate to another lender or to another account that you may have that holds a similar security or the same security. If you don't have it, then we look to another lender in our program.

Ms. Moore stated that it would seem that we're not going to lose any flexibility. Mr. Dahill confirmed that you can sell the securities at any specific time that you want. Mr. Huff explained that we take advantage of the large portfolio of lenders that's in their universe.

Mr. Dahill explained that there are instances where a security becomes very high in demand and we'll have 100 percent of that security out on loan. What we do then is we recall the borrower. We will tell him that they need to send it back to us on settlement date for your manager's sale. If they fail to return it, we AutoSettle your account; we credit your account with the cash proceeds of that sale so your manager is whole. And we penalize the borrower by dropping his rebate down to zero. If the borrower fails to return or goes into default, we can then seize the collateral, liquidate the collateral, and then repurchase those investments to cover our advance that we made to your account.

Mr. Huff asked how much in absolute dollars do we anticipate on a yearly basis. Mr. Dahill stated that the profit that you would make would be approximately $134,000. And that was based on your asset valuation of September 30, which was about $600 million. As I heard earlier, it's gone up in value to $688 million. So the larger your portfolio becomes, the greater that spread becomes on a larger balance and the greater the profit becomes.

Mr. Dahill pointed out the institutions that participate on page 3. Page 4 shows what their agent structure looks like. He stated: JPMorgan sits in the middle and has a contract with you as the lender and a contract with our counterparty, the broker-dealers. We deliver and receive securities. You have direct recourse against the counterparty, being that if anything were to happen to JPMorgan, the contracts that we have in place would allow you to look through to the underlying borrower to claim back your securities or to seize the collateral in the event that anything ever happened to JPMorgan.

We indemnify you against counterparty default, so JPMorgan does a rigorous credit review of all the counterparties that we are lending the securities. We're so comfortable that these are fine, high-quality institutions, that we're willing to put our capital on the line. Should anything happen where our borrower goes into bankruptcy or default, we will replace the value of your securities. You know, if we have insufficient collateral, JPMorgan reaches into its own capital pocket and will replace the value of your security.

Similarly, we have an indemnity against collateral default. When we are taking securities as collateral, one of the competitive advantages of JPMorgan is we're the largest clearing agent of federal book entry items. So the borrowers are able to pledge their collateral box versus the securities that they are borrowing. And because we see what collateral they clear through the Fed every day, we are completely comfortable that we can secure and segregate enough collateral on behalf of these loans that should anything happen where we were to go and liquidate that collateral in a default situation and it turned out to be insufficient because of market increases or the timing, JPMorgan would indemnify you for any potential losses or risks associated with securities collateral.

The main risk to you as a lender is the cash collateral reinvestment. So, under JPMorgan, we have the financial asset management arm, which is over 600 billion in fixed-income assets under management. We leverage their credit research to evaluate and select the names that we can purchase for you in the commercial paper or in the timed deposits or in the medium-term notes. And we are happy to say in our program, we have never had a principal or interest payment fail to be paid by the investments that we have made on the cash collateral for our lenders.

Mr. Huff asked if there was a list of firms that you would only lend securities to, and do they have an ongoing relationship with JPMorgan? Is it just totally based on collateral or is it relationships or what? Mr. Dahill responded that it's relationships. If the borrowers don't have an existing relationship with a bank where we are either lending them money or helping to underwrite some of the issues that they're putting out there, we will not lend the securities to those borrowers. So we have a dedicated credit research that reviews the balance sheets as well as, you know, understands the financial situation; because we are lending them our money.

Mr. Huff asked, for example, if you've got a hedge fund customer and they want to short some stock and they want to borrow. We've got the stock in our portfolio. They borrow the stock. The value of the portfolio drops dramatically, whereby there's not enough collateral to cover our securities. Now, what do you say would happen in that instance?

Mr. Dahill responded that they lend to mostly -- to like Goldman Sachs, for example, who has a hedge fund open. So, for example, if Goldman Sachs wanted to return all of your securities and we needed to fund that return with all the collateral that they had pledged, but the value of that collateral was insufficient, on a cash side, that would be at your risk. On the security side, JPMorgan would indemnify you should we have to liquidate those federal book entry items to replace the securities.

Mr. Huff asked for clarification, questioning if this was a risk in principal. Mr. Dahill replied that it would be a risk in principal, for example, if something in your portfolio was significantly underwater. In other words, if we were on a fixed-rate instrument at 1 percent and rates went up to 2 and a half percent and we had to liquidate that to fund the collateral back to the borrower, then. there would be risks associated with that. As I mentioned, we have not had an issue like that in the JPMorgan program. That's a hypothetical risk. Again, we're investing in A1-plus. It's very high credit quality. So the chance that they diminish in value would be very small. And, again, we manage the liquidity, so we're investing on an overnight basis. If we're buying repo or overnight commercial paper, the chances of that being liquidated or decreasing in value are very small.

Mr. Huff further asked if they would purchase anything that's not an investment grade. Mr. Dahill stated that they would not do anything that's below an investment grade. Mr. Pellecchia explained that the collateral is marked to market, meaning if the stock price went up, the borrower would owe money to get them to the 102 percent threshold. Mr. Dahill confirmed this, stating that they marked to market daily each borrower. So if the value of the security -- of the collateral in hand falls below the value of the security, we request additional collateral from the borrower through the market-to-market process. And, again, as the value of your outstanding loans increases, that spread, that 28 basis points that we've shown you, will increase your overall profits. Typically, the borrowers will want to return a stock that's going up in value and borrow a stock that's going down in value.

Mr. Huff asked who would be monitoring the amount of our securities at any given time that will be loaned out so that we will know that we are due X amount of revenue based on the basis points, who would know at what point what amount of security is loaned out. Mr. Pellecchia stated that they provide a report. Mr. Dahill confirmed that they provide online reporting as well as detailed monthly accounting statements by CD-ROM which you can see the value of the collateral versus what the value of the security is that's out on loan. And, for fixed-income securities, because you're going to sell those with accrued interest, we market to market.

Ms. Emfinger stated that the Investment Committee will be looking at those reports.

Mr. Dahill said they would show you a report of who the outstanding loans are. We would give you a performance evaluation: we project that you are going to make $134,000; how have you performed actually. You know, a lot of things factor into that. And that projection, if you changed all of a sudden to a 100 percent international equity, that 134,000 would go up significantly higher because the spreads associated with that asset class are higher than others.

Mr. Huff asked who makes that decision if we go to international. Mr. Dahill responded that securities don't drive your asset allocation decisions. Your asset allocation decisions drives how much money you can make in the securities lending program. So the more exotic investing in international, the higher the return.

Mr. Pellecchia stated that asset allocation was based on how much risk you want. Mr. Huff asked if it would matter if for example, you added emerging markets to the international allocation. Mr. Dahill answered that the category would matter because dividend-paying stocks on the international have higher earnings. Emerging markets tend to trade off news, like the energy stocks and the telecom stocks. Those have been in high demand because there's been a lot of shorts in the market.

Mr. Huff, to clarify, stated that if we had a higher percent of our international in emerging markets, potentially in the securities lending, it would generate more revenue. Mr. Dahill confirmed that this was correct. Mr. Pellecchia stated that he didn't think that you would want to do that, and Mr. Huff responded that he didn't either but was just trying to understand.

Mr. Dahill then moved to page 5 in the presentation to show how earnings are generated. Again, we take the cash collateral from the borrower on the left-hand column and we reinvest that. And in a two and a half interest rate environment, we're going to earn 2.65 investment yield. We need to pay the borrower a return on the collateral that they pledged to us, which is 2.15 in the form of a rebate. The differential between the two is the 40 basis points. That 40 basis points then is applied at the predefined fee split -- in this case, 70/30 -- showing that you would make 28 basis points and JPMorgan would make 12 basis points on the transactions. All transaction costs associated with the delivery and receipt of the securities are absorbed by JPMorgan as part of their fees.

On the right-hand side is the non-cash collateral example, which there is no trading in; there's no rebate paid to the borrower; it's simply a flat fee. Typically, they're a little bit lower in overall earnings, maybe around 20 basis points as opposed to 40 basis points: but for the point of comparison, we put them down here as the same.

You talked about how this will affect your managers. We will not affect your managers at all. JPMorgan will maintain the records of the position as if it were not out on loan, so you will have all of your entitlements, whether they be dividends or interest. Any corporate actions will be collected by JPMorgan and through our AutoSettle and AutoCredit function paid to your manager on a timely basis.

We have our global custody network throughout all of the markets that we're currently in right now. We're lending in 29 markets. So we have a swift network to recall those securities. We operate globally in New York, in London, as well as in Sidney, Australia. So we truly follow the sun. And we can lend your securities 24 hours a day.

We have a very low fail rate. Less than one-half of one percent of all the trades that come through securities lending actually fail. And if they do, we AutoSettle your account so you will have the proceeds.

Timely collection of income and corporate actions. Corporate actions are very critical. One missed corporate action could result in a significant loss, so JPMorgan contractually requires the borrower to take up whatever action you as lender determine is appropriate for your portfolio. So that would mean you would probably make those investment managers -- let them decide whether or not they are going to tender some shares or whether they're going to vote on a particular merger or something that's out there. So JPMorgan has its contracts in place with the borrower to require that they act in the same manner as your investment managers or you would as lender. Again, JPMorgan absorbs all transaction costs.

I'm just going to give you a sense of the risks on page 7. We broke them down into operational, investment, and borrower insolvency. Let's start with the operational risks. Again, we will not deliver the securities out of the bank until we receive the collateral from the borrower, so it's delivery versus payment. So until we receive the collateral in, we're not going to release your securities, because JPMorgan indemnifies you. Should we not have the appropriate collateral on hand, it's JPMorgan who's at risk. So we insulate you against that risk by receiving collateral before we release the securities. Again, we talked about the mitigation of that by maintaining a margin of 2 percent on the same currency and 5 percent on dissimilar currencies. And we market to market those on a regular basis to maintain those collateralization levels. And should anything happen where the collateral was not in place, JPMorgan's capital would be at risk.

Mr. Dahill continued, stating that on the borrower insolvency or the default side, we indemnify you against the borrower defaulting. We evaluate the credit, as I had mentioned, of each one of these borrowers. So in a separate area outside of securities lending, in the broker-dealer finance group within JPMorgan, they determine how many securities we can put out on loan to each one of the broker-dealers.

They may say you can put out 5 billion to Goldman Sachs; and then if their credit situation improves, they may increase that line to 10 billion. So we in securities lending are not making the decisions on how much we can loan to a particular borrower. We rely on the broker-dealer finance arm, who is actively lending to those counterparties and evaluating their credit to make those decisions for us.

Again, we have the opportunity to provide you with our borrower list so that should you feel uncomfortable with a particular broker-dealer, you have the ability to eliminate them from your list. We also will announce to you when any new borrowers are added to our program to give you a time period to say yes or no, I do not want to do business with this particular counterparty. And, again, we feel comfortable with all of our counterparties with our credit research that we indemnify them should they not be able to meet their financial obligations.

Typically, in any default situation, borrowers would like to have as much cash on hand as possible to pay out their creditors; so they would want to return those securities to get back that margin value as well as the cash in hand to settle out any associated payments with the bankruptcy.

What sits in the middle is the investment default, which is primarily risks of the lender. JPMorgan in funding asset management has over $600 billion in assets under management. They make all the decisions on our buy list of who we can and cannot purchase securities from. We went through here a little bit of the evaluation process that they decide for our investment managers as far as what they can buy. They determine whether or not we can go out to three years or five years. They set the duration limits, they set the time limits, they set the credit limits for each one of these counterparties that we can be investing in.

We have a compliance process associated with this, where we build your guidelines into our asset management system, so that if you have a concentration of 10 percent of your portfolio and your outstanding portfolio is $100 million and we try to put a $20 million piece of paper in your portfolio, our system will not allow that to happen and an error message will pop up and the portfolio manager will be told what is the correct percentage or the correct dollar amount that they can put into your account.

In addition to the front-end compliance, we have a back-end compliance check, where JPMorgan asset management reviews all of the issuers and all of the purchases that we've made on a daily basis; and any exceptions that come up are escalated to senior management and need to be resolved within 24 hours. Should we put something into your account that was out of compliance to your guideline and anything happened to that, that would be JPMorgan's risk as we were in violation of the provision associated with what we can purchase in your portfolio.

On the next page, I wanted to give you in writing what our standard of care and our indemnification language is. Our standard of care talks about within your contract, there are certain provisions. If we don't meet any of those provisions due to our neglect or bad will or willful misconduct, JPMorgan would be responsible for any costs or expenses, damages, or liabilities that are an outcome of that action.

Similarly, as I addressed earlier, our indemnification is written up here so you can see that JPMorgan will replace, based on its $104 billion worth of capital, the value of your securities as they fall on the market. And should insufficient collateral be on hand, we would look to that capital base to support the replacement value of your securities.

Page 9 talks about, in summary, some key differentiating features of JPMorgan's program. We blend our corporate finance, which evaluates the borrowers; our clearance business, which clears all the federal book entry items; and our securities lending relationship with the broker-dealers to maximize the revenue for the participants in the program. We are a top-tier, global custodian. We're in pretty much every market that there is out on the street. So we use that expertise to provide quality service to you as lenders.

We have 126 borrowers currently in our program. That helps to maximize return by having a large distribution network and minimizes your risk because you have diversification among different broker-dealers. We can take collateral versus our broker-dealer clearance box, something that only JPMorgan and Bank of New York can do. No other lending agent out there can do that, because we're the only two clearance agents. And that's a riskless transaction for you.

Again, we have our comprehensive indemnification. As I mentioned, we have a dedicated cash collateral management. As opposed to some of our competitors, our cash collateral investment manager sits right next to our loan negotiators. So if they're doing a big trade for your account, they know when and if the additional collateral is coming in so that they can prepare and look and see what investment options are out there in the market. Some of our competitors have them in completely different buildings, so all they know is that at three o'clock, we get to see what the balances are and we need to be fully invested, as opposed to knowing what the flows are throughout the day.

We have a compliance process on the front end and on the back end. We also have a proven contingency and disaster recovery plan. And we were able to operate after 9-11. My office is very close to the World Trade Center, about 15 blocks away. We were able to relocate the very next day into our Metro-Tech facility in Downtown Brooklyn. We also had the Northeast blackout, and we were able to run on backup generators when all the power went on in the Northeast, and we were able to provide market to markets and operations for all the securities lending after those disasters.

For the Republican National Convention that happened this past August, we sent staff over to our London office on the investment management side and we sent staff to our Dallas office on the loan negotiation side so that we could test further regional contingency sites. And we are happy to say that those sites worked 100 percent. So should anything happen where all of New York goes out, we could truly move our operations to either London; Dallas, Texas; or Sidney, Australia, something we're very proud of.

We have a strict credit review process on the borrowers and on the cash collateral investments. And, again, this happens independent and outside of the JPMorgan securities lending four walls both for the broker-dealer finance as well as the asset management arm. We have tax, legal, and regulatory expertise on the ground in all the markets that we are lending in so that we can support the due diligence necessary to lend assets in those markets and those tax bases. So that concludes my presentation on securities lending.

Again, once you start lending, you can set up some of the details on where you want your income credited, do you want it to go back to the investment managers. That will enhance their performance, and it's something that you need to consider if you're paying them on a performance-based method -- or if you have a cash account where you want us to credit the income to a distribution account where you pay your fees out. Also what types of reporting; do you want to see who the investment account is, do you want to see who your loans are outstanding to, or do you just want to see how much money that you're making. You have to tell us what it is that you want to see. And we can show you what some of sample reports look like. But, again, that's once the process begins.

I know contracts have recently been submitted to you for review with the securities lending program. So in that process, all of these parameters of the program will be ironed out.

Mike Gallagher then introduced himself as the relationship manager, stating that he was from Louisiana. Chairman Ivey thanked Mr. Dahill and Mr. Gallagher for the presentation.

Agenda Item IV. B. (1.)
Chairman Ivey called the Board's attention to the resolution dealing with securities lending and the amendment to the Investment Polity to allow international equity management investment of up to 10 percent in emerging markets.

Mr. Huff made a motion to approve the resolution, with a second by Dr. McGee. The motion was unanimously approved.

Agenda Item V. A.
Chairman Ivey called on Marty Lee to give the 2004 audit report, stating that the Board has had the report for at least two weeks for review.

Mr. Lee stated that Management's Discussion and Analysis outlines what would be presented. He further stated that this was an unqualified opinion in accordance with generally accepted auditing standards and government auditing standards. These standards require some internal control testing and compliance work, but do not require an opinion on the internal control or compliance to determine that these financial statements present fairly the financial position and operations of the PACT Program.

Mr. Lee called the Board's attention to a letter to the board of directors basically outlining the conduct of the audit. It gives certain information that we're required to present to the Board regarding the audit and briefly talks about our responsibility, which I just mentioned was to perform the audit in accordance with generally accepted auditing standards and government auditing standards. It asks that we disclose any significant accounting policy changes or anything that might be on the horizon that the Board needs to be made aware of.

There's a new accounting standard with regard to deposit and investment risks that the PACT will have to adopt next year. Mr. Lee stated that he was working with Brenda and Daria on what it would entail.

Any significant or unusual transactions I am required to identify, and I am happy to say that there was not anything significant or unusual that I felt needed to be brought to your attention. It's my obligation to touch base with you to let you know that there are significant estimates in these financial statements; the most significant estimates, obviously, being the actuarial computations that your actuary does and the responsibility that the Board has to work in conjunction with that Actuary to make sure that those estimates are as reasonable as possible.

We had no audit adjustments, which is outstanding and a testimony to the people doing the work. We don't audit anything in the PACT brochure other than the financial statements, but we do review the brochure to make sure that there's not anything inconsistent with the financial statements. Furthermore, there were no disagreements with management and there were no consultations with any outside auditors or accountants by management where they might disagree with policies or procedures or anything of that nature. So, basically, this letter is about as clean an opinion as you can get. There were no important matters to bring to the Board's attention.

Agenda Item V. B.

Chairman Ivey thanked Dan Sherman for providing lunch and invited everybody who could to stay for the Long Range Planning Committee, which will follow.

Mr. Sherman began a discussion of the 2004 Actuarial Report by calling the Board's attention to the Executive Summary. He stated that the unfunded liability status had actually increased to $65.2 million as of September 30 of 2004 as compared to last year, when it was at $51.8 million. The increase was due to a change in the tuition assumption from 7.1 up to 7.5 percent adopted by the Board at the spring meeting. That change added about $21 million to the liability and also to the deficit. Prior to that change, the deficit would have been $44 million. The actual gain on the assets was 10.07 percent. 9.02 percent is the average return since 1990. This generated a gain of $6 million against the unfunded liability.

The tuition increase for last year was 7.43 percent, and the assumption was 7.1. This year's weighted average tuition increase was $4,369 for the public four-year universities, which is an increase of 7.3 compared to 2003, a value of $4,071. The junior college increase was from $2,471 to $2,741, an increase of 10.9 percent. Compared to the old assumption of 7.1 percent, both of those are higher, which created a loss of about $3.9 million.

Concerning the beneficiaries, we found a .3 percent enrollment bias to the more expensive schools for the junior colleges. Basically, what the bias means is since students have a choice of where they go to school and not all schools have the same price, oftentimes we expect some bias for the students to select the more expensive schools. And in this case, for the junior and community colleges, we had .3 percent enrollment bias to the more expensive schools. And that generated a loss of $9,000.

For the four-year universities, there was a 6.8 percent bias to more expensive schools. That's actually down a little bit. Last year, it was over 7 percent. Our assumption was 5 percent. That generated a loss of $479,000.

The last category is payments to the out-of-state community and four-year colleges. There we actually had a bias gain of $356,000. So the net result was a very small loss of $50,000 on account of bias.

Our assumption concerning credit hours is that 15 percent of all credit hours will be used by junior and community colleges. And it's been hovering around the 15 percent category for many, many years; and this year is no different. Last year, 15.1 percent of credit hours were used by junior and community colleges.

63 percent of beneficiaries are going to Alabama universities, 15 percent to out of state, 7 percent to private institutions, and 15 percent to community colleges.

In other trends, assuming that everybody starts college once they leave high school, we should have spent $43.7 million in tuition. However, we only spent $38.5 million, which means people are delaying or deferring college. The difference between the $38.5 million and the $43.7 million does turn into a gain; because we're assuming that we're going to pay it right away; and to the extent we still have the assets and our investment returns are earning 9 percent and the tuition increase is at 7.5, that difference creates a very small gain.

Another trend that we've been seeing for many years is that the average number of credit hours used in a particular year has been decreasing. For four-year universities, it decreased from 11.705 down to 11.564. For junior colleges, it decreased from 10.15 to 9.925. Students are not taking as many credit hours as they could. That also generates gains in the system because you're pushing out the payments into a future year.

The last section of the report gives more details on the gains and losses in the past year. There was a deficit in total of $51.8 million last year. We had tuition increases greater than expected at the cost of $3.9 million and a very small bias of .1. In assets, we had a gain of $6 million, and we also sold about 1500 new contracts. Because of aggressive pricing of the contracts, through cash and accruals, there was a $3.6 million gain. Because we haven't been paying as much out as we expected, there is a $4.8 million gain. Contract payments added $2.1 million for the gain. And then we have another catchall category at .1 million dollars.

In summary, we had $44.1 million loss based on the experience of the program, and then we have a change in the tuition assumption to 7.5 percent, which added $21 million to the loss, to get us to $65.2 million.

1-5 is a graph which shows a forecast of cash flow. Total assets will increase for some period of time and then start decreasing. This year for the first time, you have actually paid out more in benefits than you received in contributions through contract payments. We're assuming no new contracts are sold in this forecast. If we overlay some forecast of new payments, it would tend to push off the point at which your assets go negative.

Noteworthy is 1-8 on the tuition and fee increases. You can see we've had some very large increases of late. There's a period from roughly 1992 through 1997 where we were below the line, which helped us get a surplus position.

Dr. Malone asked Ms. George what she was hearing concerning tuition increases and cost containment in the future. Ms. George stated that she was hearing that they were trying to contain costs.

Chairman Ivey asked Dr. Malone to clarify, and he stated that he was referring to the containment of tuition increases. He stated that he had attended some state board meetings and they are very concerned about the rising costs and when is it going to end. And the same thing is being heard from the various boards of trustees around the state, too. Dr. Malone then told Mr. Sherman that there seemed to be sentiment that we will need to factor into our future discussions about are we at the point of breaking the elasticity.

Mr. Sherman shared with the Board a copy of the recent Trends of College Pricing from College Board. He stated that the report shows the historical tuition increases going back to 1976.He pointed to the rate of increases in 1981, '82, '83, '84, a period of hyperinflation. And then in '91 through '93, we had a period of recession, and again, of course, the most recent recession starting 2001, 2002. And there's a direct correlation between the times we had either hyperinflation or a recessionary period and when tuition increases went up substantially. Mr. Sherman stated that that if you go from the period of 1976 to 2004, the average rate increase over that entire period was 7.78 percent; and from 1984 to 2004, it was 7.35 percent. He stated that he thought the Fed would keep a clamp on inflation in the future; but, still, tuition increases would be well up in the 7.5 percent range.

Appendix C gives some sense on a terministic basis, if we don't sell any more contracts and we just run the fund out, what happens to the funded ratio assuming all assumptions are met. The funded ratio stays up around 90 percent in the next 8 or 10 years, but then it drops off rapidly.

Appendix D-4 is the 2004 enrollment figures, which show a lot of sales to new parents, basically. The first couple of years of the program, it was fairly even across all ages of beneficiaries; now we're seeing a greater concentration of the very young.

Mr. Pellecchia asked if the loss on an actuarial basis by the change in assumptions for the year was just a onetime loss. Mr. Sherman stated that it was a onetime and now the assumption is seven and a half, meaning there is a greater likelihood that we'll have gains in the future; because if we get back to 7.1, we will start generating gains.

Dr. Malone stated that was one of those systemic things about our own processes and procedures with looking at those ratios. That was a good decision to make and probably long overdue. We need to continue to make sure we're asking the right questions about all aspects of this, not just the asset allocation.

Chairman Ivey thanked Mr. Sherman for his report and it was received as information.

Chairman Ivey announced the next board meeting on May 25.

The meeting was adjourned at 12:50 p.m.

Kay Ivey

Kay Ivey

<u>Adopted Resolution</u>

PACT Board of Trustees at its meeting on February 23, 2005
Topic: Selection of PACT Payment Processor

Whereas, the procurement of professional service providers is subject to the issuance of requests for proposals requirements of Section 41-16-72(4), <u>Code of Alabama</u> (1975); and,

Whereas, the Board of Trustees desires to select a Payment Processor through a competitive selection process open to all qualified business entities; and,

Whereas, the Board of Trustees ("Board") the Board desires to proceed with the selection process in an expeditious manner; and,

Whereas, the Board at the meeting December 8, 2004 authorized the staff of the Treasurer's Office to distribute the Request for Proposals as approved by the Board to all interested entities; and,

Whereas, a Request for Proposals was published on the website of the State Treasurer and letter notices of same were mailed to 32 vendors on the state purchasing list directing them to the Treasury website; and proposal responses were received from two (2) banks that have provided payment processor services in the past and each having provided good quality services; and,

Whereas, a pricing comparison was constructed and analyzed by the duly authorized staff personnel of the College Savings Program of the State Treasurer and the recommended selection was made based upon the most competitive price; now

Be It Resolved that the Board does hereby select Regions Bank to provide payment-processing services provided a five-year contract between the Board and Regions Bank could be negotiated and executed.

<u>Agenda Item</u>

Adopted Resolution by the
PACT Board of Trustees at its meeting on February 23, 2005

Topic: Investment Policy Amendment for
Securities Lending Investments and
International Equity Manager investment in Emerging Markets

Whereas, Section 16-33C-5 of the Code of Alabama vests in the Board all powers necessary or convenient to carry out the purposes and provisions of chapter 33C; and

Whereas, Section 16-33C-5-3 of the Code of Alabama empowers the Board to invest as it deems appropriate any funds in the PACT Trust Fund and the Board desires to invest all available funds for the benefit of the participants in the Trust Fund; and

Whereas, the Callan Associates Consultant has recommended that the Board amend the Investment Policy and Guidelines Statement ("Investment Policy") adopted by the Board on August 25, 2004 to provide for and allow Securities Lending as an additional investment opportunity; and

Whereas, the Board has received information from the selected Master Custodian on the financial benefits of a Securities Lending program for the Trust Fund; and

Whereas, the Consultant to the Board has further recommended an amendment to the Investment Policy to provide and allow for investment of up to ten (10%) percent of the market value of the international equity portfolio in emerging markets; now

Therefore, Be It Resolved, that the Board approves the below specified amendment of the Investment Policy under the Securities Lending heading to include and allow the Trust Fund to engage in a Securities Lending program as follows:

Securities Lending

Securities lending is permitted as an opportunity to earn additional income. The policies and guidelines governing securities lending shall be with the master custodian, unless contracted otherwise.

The objective of securities lending is to earn income through a conservatively operated and well-controlled program. There is no absolute return expectation; rather, income is expected commensurate with the market demand for the securities made available by the Fund and the return earned on the investment of cash collateral. Cash collateral received will be invested in a high-quality investment program that emphasizes the return of principal, maintains required daily liquidity, and ensures diversification across approved investment types. Those objectives are pursued within the parameters governing the program as outlined in the securities lending agreements with agent banks. Each agent bank is required to act as a fiduciary with respect to the Fund, and to have systemic and procedural controls in place to ensure adherence to guidelines for operating the securities lending program on behalf of the Fund. The results of the securities lending program are reported to the Board on a regular basis.

Be it further resolved, that The Board directs the Investment Committee to monitor the Securities Lending Program for any required action and in the periodic accounting for the funds generated through the Securities Lending Program.

Be it further resolved, that the Board approves the below specified amendment of the Investment Policy under the International Equity Investment Managers Guidelines heading to allow for investment in emerging markets as follows:

Guidelines

1. Equity holdings shall be restricted to readily marketable securities of corporations that are domiciled in countries outside the United States or generate most of their revenues outside the United States. The securities shall be actively traded on major exchanges in these countries or in the U.S. Equity holdings may include American Depositary Receipts traded on U.S. exchanges. Convertible preferred stocks may be held. Exposure to Emerging Markets securities shall be limited to 10% of the market value of the portfolio.

THE ALABAMA PACT PROGRAM
MEETING OF BOARD OF DIRECTORS

MINUTES
APRIL 14, 2005

BOARD MEMBERS:
Ms. Kay Ivey, Chairman
Mr. Ed Sherling
Mr. Willie Huff
Dr. Harold McGee
Ms. Sarah Moore
Dr. Mike Malone
Lt. Gov. Lucy Baxley (represented)
Dr. Roy Johnson (not present)
Mr. Bill Drinkard (not present)
Mr. Ricky Jones

ALSO PRESENT:
Ms. Daria Story, Assistant Treasurer
Mr. Anthony Leigh, Deputy Treasurer
Mr. Roman McLeod, College Savings Program Coordinator
Mr. Mike Manasco, Treasury Legal Counsel
Ms. Brenda Emfinger, College Savings Program Director
Ms. Sherry Mack, Court Reporter

Pursuant to written and public notice, a special meeting of the PACT Program was held in Room 300, RSA Union Building, 100 North Union Street, Montgomery, Alabama, on Thursday, April 14, 2005, at 10:00 a.m.

CHAIRMAN IVEY: We'll call the special-called meeting of the Board of Directors of the PACT Program to order, April 14th, 10 a.m. Ms. Emfinger, please call the roll.
(A roll call was conducted.)

MS. EMFINGER: There's a quorum present.

CHAIRMAN IVEY. Thank you. I'd like to ask the Board's permission to rearrange the order of our decision items. Dr. Johnson has told us he can be here from 10 to 11. And so I'd like to reorder so that we might take items III.E. and III.F. at the top of the decision items, with your permission.

DR. McGEE: So moved.

MR. HUFF: Second.

CHAIRMAN IVEY: Thank you. The agenda will be reordered.

We'll move to the report on the PACT marketing for 2005, Deputy Treasurer, Anthony Leigh. Recall that the Long-Range Planning Committee had recommended that we have an aggressive marketing plan for the PACT Program for '05. And so Anthony and staff are here to report.

MR. LEIGH: In your folder is an overview of our plans for marketing. Obviously, our objective is to increase awareness of the upcoming enrollment. And I believe in discussions later on, we will talk about a four-month enrollment period that we're going to have - June, July, August, and September. Target audience is the general public as well as key influencers, in-state university alumni, and existing PACT account holders. We believe that word of mouth among existing account holders is our best form of marketing.

Budget is about $95,000, which includes brochures, which we'll print a few more this year than we have in the last couple of years. We are going to continue our sponsorship with the Crimson Tide Sports Marketing and the Auburn Radio Network for radio ads during football games. And we're also going to have some cable television advertising. And some of that is broken down under brochure distribution in the marketing and the advertising.

One of the things that we have tried to generate a lot of in the last two years, in which we will continue to push hard on this year, is free media: op. eds. and press releases in newspapers, as well as articles and advertisements in trade association publications and magazines, and also in university alumni publications. We'll also be sending out the PACT UPDATE to existing accountholders in the upcoming weeks, and we will include enrollment information in that as well.

CHAIRMAN IVEY: Any discussion?

DR. McGEE: Question. Since you're going to target the in-state university alumni, you said you're going to work on their publications. They all should be putting out sometime this spring a fall edition. They get one out early in the fall. Thought maybe you might want to try to get an article or a public service announcement or get something in those alumni journals at that point, if that's going to be one of your targets because they read that one. It's the one that's got homecoming news, important changes, and who retired and who got fired and all that kind of stuff.

(Sarah Moore entered)
CHAIRMAN IVEY: We're talking about having the enrollment period open for four months, June, July, August, September and have a promo that says if people enroll prior to July 15, we would waive the $100 application fee.
I'm going to ask general counsel, Mike Manasco, to speak to Item III.E.,

MR. MANASCO: We'll be doing the disclosure statement and the rules under III.E.?

CHAIRMAN IVEY: Disclosure Statement, MasterPACT, and PACT rules. And y'all would recall that this Board is to provide accurate, clear, useful, and usable information to our potential buyers and current PACT contract holders. Previously, we've had three separate documents. With a great deal of effort on staff's part , all of this has beenconsolidated.. So I've asked Mike to review this with us.

MR. MANASCO: Thank you. As the Treasurer has indicated, we began this process, knowing that we had three separate documents that were utilized to disclose the PACT Program, interpret it, and inform the purchasers.

The disclosure statement and the application were in our small brochure that came out annually. The MasterPACT was sent in their year of purchase. Thereafter, no further MasterPACT was distributed. And the Rules related to the program were on our web site. So the primary thing they had was the Disclosure Statement, application, and the MasterPACT when they first purchased.

So we undertook to try to bring these documents together for a unified approach. And one of our first decisions was to delete the MasterPACT. That document was a summary of the law and the Rules. And it had the burden of anytime you tried to summarize something, you leave out some specifics that a small change in the fact could substantially change the interpretation of the Rule. It was essentially for the new enrollees but it changed from year to year, and its only distribution was on the web site. So we decided that the best thing to do was to delete it and to bring the Rules together with the Disclosure Statement in one location, that being in our annual brochure. Each year's subsequent Disclosure Statement will replace the prior one and it will always be available in the brochures. So it provides for a better communication vehicle, centrally located. that people can have updated.

And then we wanted to resolve any inconsistencies between the MasterPACT and the Rules and to define our terms. As we go through any legal document, generally, when you have capitalized terms, like designated beneficiary, projected college entrance date, or enrollment year, it's capitalized to draw attention to the reader that these are defined somewhere and they have prominent importance. And over the years, there had been many different terms used and different capitalizations. So that was one of the things that we wanted to do as well.

We have continued in our process, even today and in your package, you'll see some lined-through changes as we are continuing to make nonsubstantive refinements. And in this regard, we'll start with the Disclosure Statement being the most important, and we'll back that up with the Rules. A Disclosure Statement is a long, legalistic-type document that few people read. Everyone should read it, but few people do. If we have it in a more friendly presentation by using bold type, space between important paragraphs and that sort of thing, we thought that that would assist. We knew that the first thing we wanted to bring emphasis to was the risk factors. And so that's the very first page of the Disclosure Statement. It's bolded and the first two paragraphs, we felt like if anyone was considering purchase -- and they just read the first two paragraphs, it says it has certain material risks, strongly urge and expected to read in its entirety. Then it says, obligations are limited, payable only from proceeds received on contract sales and earnings from investment. It provides that there is no recourse against the Treasurer by the purchaser or designated beneficiary or the Board or the PACT Program or any state or federal agency or the State of Alabama; and that the obligations are not backed by the full faith and credit. We felt that if they just read these first two paragraphs, they would have the essential risk information that they should have. Then we went into describing the program and introducing it, and we went into definitions. And one of the things we did with the definitions was to alphabetize. There were many definitions in the Rules that showed up more in terms of topic as opposed to an alphabetical presentation. So if someone is looking for something now, they'd be able to find it alphabetically and move on along. And we bolded and we made those more readable. Then we went to risk factors and other considerations. Again, the very first one is no guarantee, not insured. And we went on to go through with various risk factors and investment risks.

We decided to present administrative fees in a table format to make them more visible and more readable. Then we talked about management of the Trust Fund and named the Board and provided the time of appointment and the mailing addresses. Then we went to financial audits, annual investment rates of return, and then purchasing. We provided tax considerations, an enhanced taxation disclosure. And we had miscellaneous for reporting and special petitions, how to contact PACT and amendment of the Rules. And we added for the first time a PACT privacy notice. This was designed to be in compliance with other Disclosure Statement formats. We reviewed several. We utilized the Van Kampen as it presented a good presentation format. And by using that, we would also have some consistency with the 529 Program. So that takes care of the high points of what we undertook to do. I would emphasize again the continued work that we're doing on the refinements are nonsubstantive.

On the PACT Rules, basically, what we did was to refer the reader back to the Disclosure Statement and we edited and deleted those repetitions. We tried to make it more concise. We updated information on matriculation. We reorganized by category and heading. And we reviewed and edited for consistency and duplication. So we will be able to have in our brochure the new Disclosure Statement, the application, and the Rules, all available for the purchaser. And it will be available to them each year through the web site, as well as through the new brochure. Each purchaser would know what Disclosure Statement and Rules covered their contract. And any prior purchaser who wants to have that information can request it.

CHAIRMAN IVEY: Floor is open for questions and discussions.

MR. HUFF: Since the contracts are different each contract period, would all contracts be available on the web site? Or the only way you can get old contracts is if you request a hard copy?

MR. MANASCO: The MasterPACT that they receive --

MR. HUFF: Not the contract. It changes every year over some period of time. And somebody came in, in like what they purchased in '91 would not be the same as '01. It's what was in effect at your time. That particular one, how would they get a copy other than just requesting it?

MS. EMFINGER: They call and ask.

DR. McGEE: Madam Chairman, I just have a minor correction in the directory.

DR. MALONE: I have one as well, minor. I have a comment - This is excellent, and the fact that you've worked from disparate documents and put them into one logical format. I really didn't appreciate that on my first reading in the packet; but now as I follow your outline, this outline here, and using your usual logical cognitive flow, it does. And so I commend you.

DR. MALONE: I move adoption of the resolution.

CHAIRMAN IVEY: Motion by Dr. Malone has been made to adopt.

MR. HUFF: Second.

CHAIRMAN IVEY: Board discussion. Are you ready for the question? All in favor say aye. All opposed say no. Motion unanimously carries.
Now we'll go to item III.F. And that is our contract pricing, pages 36 through 40. And page 36 is the resolution that we will be considering. Page 37, you recall, is the present assumptions that we're operating under. And then we have scenarios to consider. And then page 38 and 39 are those same scenarios 1, 2, and 3, but broken out by extended payment, five year, or the life of the contract. So we're on page 36 and following. Dan, what would you advise?

MR. SHERMAN: What we did, pricing scenario number 1 on page 37, just to give an overview, is the same assumption that we used last year brought forward. Last year,.for example, 2006 would be 9 %. So we're just carrying that forward into the new year but the same set of assumptions, for 2006 would be 9 %, 8 % and 7.5 % thereafter.

In looking at the valuation results – and if you recall the February meeting where I presented the result -- we looked at all the actual assumptions, gains and losses, and sources of gains and losses to look to see if there's any particular spot or indication of something that was amiss regarding the actual experience versus our assumption. And in that review, the assumptions, I would say, below the investment return, which is that middle section which had to do with enrollment(85% four- year and 15% two-year), cancellations, credit hours, and all the other assumptions down below were still holding up very well. But the key assumptions that have not held up as well and are much more volatile, of course, are the investment return and the tuition increases.

So what I did for scenarios 2 and 3 was to leave the investment return assumption as is because we lowered those rates substantially last year for all ages. So I concentrated on what kind of changes might make sense for this Board to consider. In scenario 2 I lowered the assumed tuition increases by 1% for each of the years '05 and '06 and then 7.5% thereafter. And then in scenario 3, 7.5% for all years into the future. And if you recall, I had indicated that these pricing scenarios are something that we can do at a click of the mouse. So if we want to see a variation on any of these, I could give you the pricings on either the lump sum, the extended, or the five year.

So given the three scenarios I have presented, maybe we just concentrate on the lump sum on page 38, which is typically what we've done in my discussion. Last year's prices are the upper-left quadrant from the 9th grade through the infant, with September of '04 from $21,000 down to

$18,000. If we maintain the same assumptions but now we're a year later, we have tuition increases and other considerations generating roughly a 12% average increase in the tuition because that's what the tuition prices went up, was about 12% last year. And we ended up with a 12% increase on the contract prices.

If we give them a break, so to speak, in terms of the future periods and look at scenario 2 where, if you recall, I lowered the assumed tuition increases by 1% for '05 and '06 and a half % for '07, you'll see it's an increase of about 9.4%. And if we have 7.5 % for all futures years, which is scenario 3, you can see the average increase turns out to be about 7.4%. So those are three scenarios but others can be generated if you so choose. I'll skip the other two pages for now unless somebody has a question.

CHAIRMAN IVEY: Let me just make an observation. In your manila folder, also, starting with pages 8, 9, 10, there's additional tuition information as requested.

DR. McGEE: I was going to ask Mike (Malone) a question in terms of one of the scenarios there. One of the options there is seeing that credit hour number drop from 135 to something as universities and colleges lower their credit hour requirement for degrees. I was wondering if Mike had a feel for that. And the second one, based on this being one of the better budget years, probably the best year since '88 in terms of what is being proposed by the Legislature, do you see any light on the horizon of tuitions holding based on better funding at the state level? Do you have any feel for that?

DR. MALONE: After this week -- and I'm probably nervous about the latter part of your question, Dr. McGee. The good news is, thanks to the Governor and so far to the two Houses, higher education has been funded better possibly than ever. And, therefore, I think it will then be difficult for the Board's trustees in this next year to allow anything but single-digit tuition increases. There will have to be tuition increases just to keep up with inflation. My concern is we're committing money for '07 and '08 that the State doesn't have and really doesn't have any prospect of having it, which makes me just real, real nervous because we may be setting up a situation in as recent as '07 quite possibly and quite probably '08 for proration.

DR. McGEE: So that means higher tuition.

DR. MALONE: Higher tuition and then here we go in the other direction.

CHAIRMAN IVEY: And the "we" to which you refer is the State of Alabama, not this Board, right?

DR. MALONE: So in answer to your question, Harold, I'm saying what about '06 at that 8%? I am now more nervous than I was the last meeting where I said I think we could have over 7.5%.

DR. McGEE: Conservative is probably a more appropriate way to approach this.

DR. MALONE: Right.

MR. SHERMAN: We've taken a very conservative approach because of a number of reasons, principally we don't want to add any more additional unfunded liabilities. Hence, we're leaving the 135 credit hours at the maximum - the average is down to 130. And we see where it's going to trend down to about 128, 127 over time; but we're going to leave it at 135 because a particular student could use all 135 credit hours. And we don't want underpricing.

MS. MOORE: And we'd rather have an actuarial gain than an actuarial loss.

MR. SHERMAN: Absolutely

DR. McGEE: It may take a while for the Universities to figure out that if they would reduce that hour requirement, they could save money.

DR. MALONE: Somehow.

MS. MOORE: You know, I'd like to just take a very simplistic approach at looking at the pricing. I think we ought to price it as high as we think people will continue to buy the contracts because we are in an unfunded situation. We have all these actuarial assumptions, we have all these estimates. But at the end of the day, you really have to look at what you think the constituents can stand because we are in an unfunded situation and we have so many uncertainties as far as tuition increases, investment returns, and we're in the hole. So, I think we have to take a very simplistic approach at looking at this. And I think a 12 percent on average increase is very reasonable. If you look at the scale on pricing scenario 1 on page 38, we're still allowed to give $22,000 to a child as a gift.

DR. McGEE: On the last column, on contract sold - as we sell less and less, what's the impact on making what we have to make actuarially to pay out?

MS. MOORE: Did we determine that last meeting? What was that number of contracts?

MR. SHERMAN: We wanted to get at least 1500.

MR. JONES: Well, I'd like to hear from the staff as far as what do they hear from people buying the contract this last year. I know from my experience with savings, we have employee saving for Christmas. They don't even get any interest anymore, but they still save because they want some money at Christmas. Do people really look at the return on this program, or do they look at the idea that they know they'll have their college paid for?

MR. SHERLING: I think that it's the latter.

MS. MOORE: I do, too.

MS. EMFINGER: That's absolutely true. They're looking to see that once they've made these payments, they don't have to worry about whether or not they're earning 5 percent, 4 percent, 10 percent, or 15 percent. They just know that if they make their payments, at the end of the day when it's all said and done, their child is going to have their tuition paid.

MS. MOORE: I think that's why it's important we did that disclosure in bold at the first of the Rules, that we're not misleading anybody. That is the psychology of why they're buying it. But the fact of the matter is, it's not a guarantee.

DR. McGEE: The buyers that I've come into contact with are people who know the child or grandchild is going to go to an in-state school. They're going to go to Alabama or they're going to Auburn or they're going to go somewhere. That's why they do this. It's a given. When they see the value from that point, they're not looking at anything else. This is a nice gift to take care of that child or grandchild down the line.

CHAIRMAN IVEY: We can also make the case that contract pricing starts at $183 a month for your child's future.

DR. McGEE: You can't beat the price. Those who bought a long time ago, they really made a good investment.

MS. MOORE: Are we ready for a motion?

CHAIRMAN IVEY: All right. Call your attention to the page 36, which is the resolution addressing pricing issue.

MS. MOORE: I'd like to make a motion that we adopt pricing scenario 1 assumptions.

CHAIRMAN IVEY: Is there a second?

DR. McGEE: Second.

CHAIRMAN IVEY: Board discussion.

DR. MALONE: Well, I'd just like to make sure our minutes indicate that even in '08, '09, '10 where we flattened the tuition there is -- at least in my mind -- a caveat that we need to watch that carefully.

MR. SHERMAN: We've been watching it very carefully every year.

CHAIRMAN IVEY: Are you ready for the question? All in favor of accepting and adopting pricing scenario 1 assumptions, say aye.

CHAIRMAN IVEY: All opposed, say nay. Ayes carry. Pricing scenario number 1 is approved for '05.

MR. SHERMAN: I'll put together a report and send the appropriate number of copies to to PACT in about a week or two.

CHAIRMAN IVEY: All right. Now let us, with your permission, go back to information item II.A. Mr. Sherling is chairman of the Long-Range Planning Committee, for his report.

MR. SHERLING: Well, we discussed the funded status, investment return, tuition costs, contract benefits and recommend that a 95% funded status is a cause for concern. To work toward a fully funded status, action is required by the investment committee to review additional asset classes for further diversification and recommend an appropriate rate of return assumption. We also recommend that staff aggressively market the program with a goal of selling 1500 contracts and spending up to $100,000 in marketing. And that's where we are.

CHAIRMAN IVEY: Very well done. We're back to decision items now, III.A., on page 5. This is an RFP for domestic fixed income manager. The Board desires to select one or more domestic fixed income managers through a competitive selection process. And we need the Board to authorize the staff of the Treasurer's office to distribute request for proposals to all interested entities as determined by State Purchasing and the PACT Program and provide access to the proposal on the web site. We need a motion.

MR. HUFF: Move the item.

MR. SHERLING: Second.

CHAIRMAN IVEY: Mr. Huff moves. Mr. Sherling seconds. All in favor, say aye. All opposed, say nay. Motion carries. Now to III.B., Peregrine contract amendment on page 6. Bottom line, contract was expiring, and we need to extend the contract so that we can do an RFP and attend to that.

MS. MOORE: Move it.

MR. HUFF: Let me ask a question. And I'm just curious about the process. Why have we not prepared and/or published the requested proposal so that when a contract expires, we not have to give them an extension?

CHAIRMAN IVEY: Mr. Huff, the staff has addressed that, and this won't ever happen again. We now have a rolling roster of contracts, and nine months before expiration, we will have a flag. This won't happen again. And with our apologies, you have that one with Peregrine and also another one I bring to you in your folder today, Rhumbline. And so we will not need to extend any contracts in the future.

MR. HUFF: So it's no problem as far as the State process of extending this without it being made available for other investment firms to respond to the extension.

MS. STORY: The contract went through a contract review, and at that time, we included a cover page as required. As you know, we pay investment managers by basis points on the market value of the portfolio, so we have to estimate an amount that we will pay them over the term of the contract. Usually, we overestimate the amount to account for fluctuations of the market value. That original estimate will still allow us to pay them six more months on the same contract. If that was different, we would not be able to extend it. You would have to go through the process again immediately. You can allow an extension if the dollars are the same that you originally contracted for.

CHAIRMAN IVEY: All right. III.B.,page 6 and 7. Your pleasure?

MR. JONES: I move we adopt.

MS. MOORE: Second.

CHAIRMAN IVEY: All in favor, say aye. All opposed, say nay.

CHAIRMAN IVEY: Motion carries.

DR. MALONE: The fact is that this is basically a pro forma extension and in no way encourages Peregrine --

CHAIRMAN IVEY: Correct

CHAIRMAN IVEY: In your manila folder, pages 2 and 3, you have a similar resolution and a very same situation with Rhumbline. And this resolution ratifies the action taken by the Treasurer to extend that contract.

MS. MOORE: Move it.

MR. SHERLING: Second.

CHAIRMAN IVEY: Any discussion? All in favor, say aye. All opposed, say nay. Ayes have it. Now we come to III.C., page 8, consideration of a resolution for domestic large cap equity manager.

DR. McGEE: So move.

DR. MALONE: Second.

CHAIRMAN IVEY: Any discussion?

MR. JONES: Who is currently this large equity manager?

MS. STORY: Peregrine.

CHAIRMAN IVEY: All in favor say aye. All opposed say nay. Motion carries. All right. III.D. and pages 9 through 12 in your packet and also 5, 6, and 7 in your manila folder.

MS. STORY: We also needed to adopt a resolution for Rhumbline - to
CHAIRMAN IVEY: Page 4 in the attachment.

MS. MOORE: We'll move it.

MR. HUFF: Second.

CHAIRMAN IVEY: All in favor say aye. All opposed say nay. Motion carries. Now to III.B., Mellon Human Resources and Investor Solutions - consideration of resolution on page 9 through 12. You have in your packet a letter Dan sent us about the sale of Mellon - selling HR Consulting Resources. So a sale has occurred, and the PACT Board has been contracting with Mellon. General counsel has reviewed all of this and the existing contract may not be assigned. If a different contractor is required, the original must be cancelled and a new contract initiated. Dan, would you like to add anything in addition to what you sent us in the packet?

MR. SHERMAN: There's some additional information that unfortunately was not at Mike's disposal. This contract that we have with the PACT Board is with Mellon Consultants, L.L.C. It is a wholly owned subsidiary of Mellon Financial. And the arrangement is not one of assignment, but it's actually a stock sale where the subsidiary, Mellon Consultants, L.L.C., is being sold to ACS and will continue as a wholly owned sub. One of the things I found interesting is that in the contract, it says the name of the contractor is the consulting division of Mellon Financial Corporation. Turns out, just a week or so ago, it's been announced the Buck name is coming back. Because Mellon Consultants, L.L.C., owns that name and a lot of people know the Buck name, we're going to resurrect the Buck name and continue forward. So for purposes of this contract being with Mellon Consultants, L.L.C., nothing has changed. It's not an assignment involved. It's a stock sale. The people, the computer systems, everything is being moved . There's about 4500 of us moved from a subsidiary of Mellon Financial to a subsidiary of ACS. So I'm still on board. All my staff is still on board. We're still in Boston. But it is not an assignment. I think that is the key point here.
The database doesn't change. Really the only thing -- if this particular contract had provision that said that something will happen if there's a change in control, then we'd have an issue because there is a change in control. But there is not an assignment - who you contracted with doesn't change. The purchase hasn't yet closed; that's going to occur in May. Once the closing is done, Mellon Consultants, L.L.C. or Mellon HR&IS will still exist as a legal entity. Nothing changes in that sense. So we'll end up changing the name of the corporation back to something that's already in your contract. But, in essence, it's the same company. We're just having a new owner as a change in control rather than an assignment.

DR. McGee: But you report to somebody new.

MR. SHERMAN: I report to somebody in Boston who reports to somebody in New York region who reports to a head. That whole structure doesn't change. Now, the person he reported to was on the Board of Directors at Mellon Financial. Now he'll be reporting to the Board of Directors. Yes, that's the change in whole, but it's not a change in corporation.

MR. HUFF: Mike, is this an assignment or not?

MR. MANASCO: It is not an assignment. It is --

MR. HUFF: So we shouldn't even be dealing with this issue, right? I mean, it's not an assignment.

MR. SHERMAN: It's new.

MR. MANASCO: I think it's a legal and significant issue. An assignment of a contract would be that you would be assigning to someone. This would be a much more significant circumstance in that it's an actual sale that has occurred.

MR. HUFF: The very same people are doing the work. It's not an assignment. So if it's not an assignment, why are we acting on this?

CHAIRMAN IVEY: I refer you to page 10, the information that Mr. Sherman provided the Board, first definitive agreement to sale Human Resources Consulting. That was all the information we were provided. This is the first conversation Dan and I have had since he sent us the news release.

MR. MANASCO: It's a sale. I think that is more legally significant than an assignment.
MS. MOORE: I have a clarification question. Under the contract, do we have the legal right to cancel this contract and solicit new people without incurring a termination penalty or cancellation fee?

MR. MANASCO: We have the right to cancel the contract for any reason. Under Section IIA, PACT may terminate the contract at anytime and for any reason by giving contractor 30 days notice in the manner described in the contract. Contractor may terminate the contract at anytime but only when PACT breaches the terms by giving PACT 90 days notice.

MR. SHERLING: The question is, is this necessary now?

MR. MANASCO: I don't think that we can just draw up a new contract with a new owner without going through the RFP process.

MS. MOORE: Well, I think the key here is that we have the option at anytime to cancel the contract regardless of the circumstances. And now that there has been a change in the entity that we're dealing with, is now a good time from a business standpoint to just go ahead and solicit RFPs and see what other firms are out there? Because at any time whether they were going through a sale or not, we can cancel the contact within 30 days; is that correct?

MR. MANASCO: Yes, ma'am.

MS. MOORE: So that's really the business decision here I believe.

MR. MANASCO: I think that the recommendation I have would be not to cancel the contract but to approve the resolution to go for RFPs. There's certainly not going to be any prohibition against ACS, Mellon, whatever entity is going to be to responding to the RFP. But if there's

going to be a new contract and I certainly think that there needs to be a new contract if -- particularly, a sale is a change of control and you're going to be dealing with a different entity.
MR. SHERMAN: I'd also point out that at the very beginning of the contract, it says, Buck Consultants, a Division of Mellon Financial Corporation to be renamed Mellon Human Resources & Investor Solutions in October 2003. Buck Consultants is the name of the contractor and will continue to be after we close in May. So there is no change in the contractor name in that sense.

MR. MANASCO: If I can address that.

CHAIRMAN IVEY: Certainly.

MR. MANASCO: The original contract that was effective October 1, 2003, spoke to a name change from Buck to Mellon Human Resource & Investor Solutions. That contract was signed on September 22nd of '03. The contract specifically deals with a name change that is set to occur nine days later on October 1, 2003. So that was part of consideration for the entry into that contract. The fact that now that the business has been sold with whom we have contracted and they're going to revert to another name does not have the same legal arena. This is an existing contract that's been sold instead of a contract we're entering into that's only involving a name change. So I think that the circumstance of that is significantly different. And in the letter, certainly, it indicates that for the foreseeable future, data will remain on these servers in accordance with transition agreements under which Mellon has agreed to provide continued use of some of its facilities until a proper transfer to comparable facilities maintained by ACS can be arranged. You can be assured both Mellon and ACS have substantial experience in the maintenance of data security, and the eventual transfer of data will be performed with the utmost regard for security of sensitive information. So the contract is with Mellon Investor. That has been sold to ACS, and the data is going to be going to ACS some time in the future. This is so much more significant than an assignment of the contract. It's beyond question from my view that we should not cancel this contract but that we should proceed forward with RFPs so the people that we would actually be dealing with, with ACS will be a respondent. And we will know from their presentation what the facts are upon which we're going to have to make a decision of entering into a new contract. And if the Board decided to go with ACS, it might very well be a seamless transition. But at this point, to look at this as simply a name change would be contrary to the legal issues as to the facts.

CHAIRMAN IVEY: Ms. Moore.

MS. MOORE: How many years have we had Mellon actuarial services? Was October 1, 2003, the first time or was that just a renewal of the existing contract?

MS. EMFINGER: Actually, Dan has been the actuary for a long time working with different companies.

MR. JONES: Madam Chairman, I'd like to move that we adopt the resolution.

MS. MOORE: I'll second.

CHAIRMAN IVEY: Questions, discussions?

MR. MALONE: Again, the reason why you're recommending that we don't cancel the contract, yet pursue an RFP, to me for common purposes that sounds counter-intuitive? Tell me why that makes good legal sense.

MR. MANASCO: Well, the existing contractor is in the process of performing services that are important to be continued for the Board, for the year end financial statement under this contract. And it would be highly disruptive to cancel the contract on a 30-day notice when Mellon is in the midst of performing these essential services.

MS. EMFINGER: And he performs current tuition value calculations for death and disability refunds on an ongoing basis.

MR. MANASCO: Mr. Huff raised the point. Would a six month extension cause this difficulty by not giving the other people an opportunity to bid on the contract. And under those circumstances not. But certainly with a transfer of ownership, we couldn't just redo a contract with a new contracting party without running into substantial difficult with the opportunity for all interested parties to bid on this contract.

CHAIRMAN IVEY: Any more discussion?

DR. MALONE: Call for the question.

CHAIRMAN IVEY: All in favor say aye. All opposed say nay. Motion carries. Other business, item 4, page 41. The Chairman and staff had a significant meeting with representatives of Van Kampen, Jeff and Mike. And in that discussion, we clearly got them to understand some of our concerns as board members for clarity and completeness and thoroughness . I believe that they've certainly got that message. And in our discussion, it sort of became clear to them -- and I know to us -- most of us on this Board that supervise the 529 program were not here at its inception. The 529 Fund and its program is different than the PACT Program, though they're both 529 IRS code-related. And it occurs to us that maybe it would be really helpful were the Board to consider spending an hour and a half maybe at the beginning or the end of the May Board meeting and have an orientation session. And this is the outline - certainly we can modify it as you would choose. I'm confident that they value the relationship with this Board, and we value the relationship with them. So I would entertain your discussion or recommendation. Could we plan for May 25, have a working lunch, and keep on for another hour and a half for orientation if you found that beneficial.

MS. MOORE: I just have a question because Van Kampen, if I'm not mistaken, said their 529 performance has been the top of the industry but yet we kept seeing all the negatives of their performance. And we're saying, how do you know that. And then we're asking for the weighted average returns of 529 compared to other industry data. Are they going to be providing us that information on a routine basis so that we can make sure that we're offering the right fund options to the participants in the 529 because I had a lot of hang-ups with some of the things they said.

CHAIRMAN IVEY: And this will be a great time to lay out for them all of our concerns.

MS. MOORE: I mean, this is almost like saying, okay, the Board, you know, y'all need to be oriented. I need them to be oriented. I want to take them to school on what I'm accustomed to seeing in different plans and what they need to provide this Board.

They were obviously representing to this Board that their performance has been the top of the industry, so my question is, how do you know?

MS. STORY: By reviewing the information that Van Kampen provides in their quarterly report which shows the underlying funds compared to various benchmarks- like we do with our own PACT. Small cap funds to small cap fund. It's impossible to compare different company portfolios because each portfolio is comprised of different asset allocated underlying funds.

MS. MOORE: I mean, they were representing that their total performance. So that's my question back to them. It's not up to me to try to figure it out. It's up to them to tell me if you're going to represent that they're doing great and wonderful then show me because we looked at all the different funds. And the funds with the largest dollars were the ones that were underperforming. I mean, there's a lot of propaganda but not a lot of data .

MR. JONES: They need to show us something that whatever funds they have compared to whatever they are indexing it to.

MS. MOORE: Well, they did that, but you couldn't tell how much dollars were in each thing. And my suspicion is the ones with the lowest dollars were the ones that were performing really well, and the majority of our people weren't performing well.

MR. JONES: But you can get a weighted average by taking the --

MS. MOORE: I asked for a weighted average return, and it may not be able to total to another index, but we ought to see what our weighted average return is.

MS. STORY: That was provided at the last meeting.

MS. MOORE: But we just hear a lot.

CHAIRMAN IVEY: Well, we clearly discussed the difference between propaganda and substance.

MS. MOORE: Good. Thank you. Because I just didn't want to get into another propaganda meeting.

CHAIRMAN IVEY: I agree. And that's what we need to have, want to have, will have. I do think it will be a good exchange and a time for us. As you say, we'll orient them and maybe we all get more -- and I bet you get hit up from time to time with friend, neighbor, and colleague tell me about this 529. What does it do? How does it do? It's different from PACT but by what? Well, it's sort of hard to go into all that stuff.

MS. MOORE: It will be good. I'm in favor of learning more about it so we can make more informed decisions.

CHAIRMAN IVEY: With permission, we'll try to plan on a little extended meeting on the 25th. Also, in other business, given the Long Range Planning Committee's report, Ed, there was a statement in there about asking the Investment Committee to consider a change in asset allocations.

MR. SHERLING: To investigate that, yes.

CHAIRMAN IVEY: To investigate it. And Ricky is chairman of that, and Ricky may want to make some phone calls with the Investment Committee to look at present asset allocations and let them bring back a recommendation of should the asset allocations be revised in any fashion. Finally, the last page in your manila envelope is an e-mail address change for the Treasurer. In fact, my e-mail is now no longer. And the e-mail address that is provided is my assistants' – Mary Frank's. I will see any emails you send, no questions asked. This will ensure that any email you send will be timely reviewed and answered.

That's all the business I have. Anybody else have any other business?

All in favor of adjourning, stand up.

(The meeting adjourned at 11:30 a.m.)

Kay Ivey

Kay Ivey

Adopted Resolution by the
PACT Board of Trustees at its meeting on April 14, 2005

Topic: Request for Proposals for Domestic Fixed Income Manager

Whereas, the procurement of professional service providers is now subject to the requirements of Section 41-16-72(4), Code of Alabama (1975); and,

Whereas, the contracts for the current large cap domestic fixed income investment managers expire in September, 2005; and,

Whereas, the Board of Trustees has approved an asset allocation that includes domestic fixed income management; and,

Whereas, the Board desires to select one or more domestic fixed income investment managers through a competitive selection process open to all qualified business entities; and,

Whereas, the Board desires to proceed with the selection process in an expeditious manner; now,

Therefore, Be It Resolved, that the Board authorizes the Treasurer to distribute the Request for Proposals and to provide access to the proposal on the Treasurer's website for all interested parties.

Be It Further Resolved, that the Investment Advisor will evaluate all responses to the Request for Proposals and provide evaluations to the Investment Committee. The Investment Committee shall discuss and review the information provided by the Advisor, and shall provide a recommendation to the Board.

Be It Further Resolved, that the Board of Trustees shall meet to select one or more domestic fixed income managers no later than September 2005.

<u>Agenda Item III. B.</u>

Adopted Resolution by the
PACT Board of Trustees at its meeting on April 14, 2005
Topic:
Ratification of Amendment to Domestic Large Cap Equity
Investment Manager Contract

Whereas, the Investment Management Contract with Peregrine Capital Management for domestic large cap domestic equity investments was due to expire by its terms on March 31, 2005; and,

Whereas, allowing the contract to expire without a replacement investment manager would have been very detrimental to the management of assets, and

Whereas, the Board was not scheduled to meet until April 14, 2005; and

Whereas, the Contract terms provided it could be amended in writing signed by both parties; and,

Whereas, an Amendment was made and signed on March 30, 2005 by the Provider and the Treasurer, as Chairperson of this Board to extend the Contract for a period of six month to expire on September 30, 2005 and is attached hereto; and,

Whereas, the Board has approved a separate Resolution for issuance of a Request For Proposals for selection of one or more large cap domestic equity investment managers; now

Be It Resolved that the Board concurs that the circumstances presented an exigent need for immediate action by the Chairperson and does ratify the Amendment.

Adopted Resolution for Consideration by the PACT Board of Trustees at its meeting on April 14, 2005

Topic: Request for Proposals for Domestic Large Cap Equity Manager

Whereas, the procurement of professional service providers is now subject to the requirements of Section 41-16-72(4), Code of Alabama (1975); and,

Whereas, the contract for the current large cap domestic equity investment manager expires in September, 2005; and,

Whereas, the Board of Trustees has approved an asset allocation that includes large cap domestic equity management; and,

Whereas, the Board desires to select one or more large cap domestic equity investment managers through a competitive selection process open to all qualified business entities; and,

Whereas, the Board desires to proceed with the selection process in an expeditious manner; now,

Therefore, Be It Resolved, that the Board authorizes the Treasurer to distribute the Request for Proposals and to provide access to the proposal on the Treasurer's website for all interested parties.

Be It Further Resolved, that the Investment Advisor will evaluate all responses to the Request for Proposals and provide evaluations to the Investment Committee. The Investment Committee shall discuss and review the information provided by the Advisor, and shall provide a recommendation to the Board.

Be It Further Resolved, that the Board of Trustees shall meet to select one or more large cap domestic equity managers no later than September, 2005.

Adopted Resolution by the
PACT Board of Trustees at its meeting on April 14, 2005
Topic: Request for Proposals

Whereas, the procurement of professional service providers is now subject to the requirements of Section 41-16-72(4), Code of Alabama (1975); and,

Whereas, Mellon Human Resource and Investor Solutions currently provides actuarial valuation and consulting services through a Professional Services Contract effective October 1, 2003 with expiration date of September 30, 2008; and

Whereas, Mellon has informed the PACT Program that its Human Resource division has been sold to Affiliated Computer Services, (ACS) with anticipated closing in June, 2005, when said division (contractor) will be entirely owned by ACS; (see email and press release attached) and,

Whereas, the existing contract provides in Section VII B that, "This Contract may not be assigned. If a different contractor is required, the original contract must be canceled and a new contract initiated"; and,

Whereas, the Board desires to proceed with the selection process in an expeditious manner; now,

Therefore, Be It Resolved that the Board authorizes the staff of the Treasurer's Office (1) to distribute a Request for Proposals to all interested entities as determined by State Purchasing, (2) provide access to the proposal on the Treasurer's website and, (3) evaluate all responses to the Request for Proposals with or without a Board Committee so that such entities that show initial merit can be selected and promptly invited to appear and make individual presentations to the Board at a designated time when the Board is convened with a quorum present; and,

Be It Further Resolved that the Board of Trustees shall meet to select an actuarial consulting firm not later than September 30, 2005.

Agenda Item III. E.

Adopted Resolution for Consideration by the PACT Board of Trustees at its meeting on April 14, 2005

Topic: Revisions to the PACT Rules and Disclosure Statement for 2005

Whereas, the Legislature has created the Wallace-Folsom College Savings Investment Plan pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act") in recognition that the advancement of higher education in the State of Alabama is a proper governmental function and purpose of the State of Alabama;

Whereas, the Plan consists of two programs, one of which is the Prepaid Affordable College Tuition Program;

Whereas, Section 2.1 of the Act provides that the State Treasurer of the State of Alabama (the "Treasurer") shall administer the PACT Program in accordance with the provisions of the Act and the rules, regulations, and guidelines (the "PACT Rules") established by the Board of Trustees (the "Board");

Whereas, the Board has determined that it is appropriate to provide, amend and supplement the Disclosure Statement and the Rules; and,

Whereas, the Board has concluded the Disclosure Statement should be combined with the appropriate non duplicative provisions of the MasterPACT and Rules; and,

Whereas, the Board has reviewed the revised documents as attached;

Therefore, Be It Resolved, that the Board approves discontinued future use of the MasterPACT and further approves the proposed 2005 Disclosure Statement that includes the PACT Rules.

Agenda Item III. F.

Adopted Resolution by the
PACT Board of Trustees at its meeting on April 14, 2005

Topic: 2005 PACT Contract Pricing

Whereas, the Board of Trustees is responsible for the approval of contract pricing for each enrollment period; and,

Whereas, the Board of Trustees has considered various assumptions used in the construction of contract pricing and with the assistance of the PACT Actuary has determined that the following assumptions are reasonable for the pricing of the 2005 PACT Contracts:

Tuition Increases: 2005 – 10%; 2006 – 9%; 2007 – 8%;
2008 and thereafter 7.5%
Bias Toward More Expensive Schools: 5% (4 year only)
Rate of Return: 8th and 9th grades – 7%; 6th and 7th grades – 7.25%; 4th and 5th grades – 7.5%; 2nd and 3rd grades – 7.75%; 1st grade and below – 8%
Enrollment at Jr./Community vs Four-year Schools: 85% at 4–Year and 15% Jr./Community
Credit Hours Utilized: 135
Tuition Payments: 9/1
Contract Cancellations: 0

Therefore, Be It Resolved, that the Board, with the advise of the PACT Actuary, adopts 2005 PACT Contract Pricing as follows: Scenario 1

THE ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM
MEETING OF BOARD OF DIRECTORS

MINUTES

MAY 25, 2005

BOARD MEMBERS:
Ms. Kay Ivey, Chairman
Lt. Gov. Lucy Baxley, represented by
Mr. Christopher Turner
Mr. Ed Sherling (not present)
Mr. Willie Huff
Dr. Harold McGee
Ms. Sarah Moore (not present)
Dr. Mike Malone
Dr. Roy Johnson (not present)
Mr. Bill Drinkard (not present)
Mr. Ricky Jones

ALSO PRESENT:
Ms. Daria Story, Assistant Treasurer
Mr. Anthony Leigh, Deputy Treasurer
Ms. Brenda Emfinger, College Savings Programs Director
Mr. Roman McLeod, College Savings Program Coordinator
Mr. Mike Manasco, Treasury Legal Counsel
Mr. Adam Harbison, Intern
Ms. Sherry Mack, Court Reporter

Pursuant to written and public notice, a PUBLIC MEETING of the PACT Program was held in Room 300, RSA Union Building, 100 North Union Street, Montgomery, Alabama, on Wednesday, May 25, 2005, at 10:44 a.m.

CHAIRMAN IVEY: Ladies and gentlemen, we'll call the meeting of the PACT Board of Directors to order. And thank you so much for being here. We'll ask the secretary to call the roll. (Roll call was taken.)

MS. EMFINGER: A quorum is present.

CHAIRMAN IVEY: Thank you. Matter of information for the Board, we have received the resignation letter of Bill Drinkard. The Governor has made an appointment as of 4:30 yesterday afternoon of Mr. Russell Buffkin of Mobile, an attorney. He communicated with us last night and said, due to short notice, he would not be able to attend but he pledged his very strong interest in the program.

Before you are the minutes of February 23 that were mailed to you for your review. And your pleasure is?

DR. MALONE: I had some editorial comments that I talked with Anthony about, and those were just form and format, basically; but other than that, I move approval.

MR. HUFF: Second. Move approval with minor edits in format.

CHAIRMAN IVEY: Second. All in favor?
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: Motion carries to approve the minutes of February 23. You also have before you the minutes of the called meeting, April 14th. They were e-mailed to you. And then I believe everybody has a printed copy. The Chair will entertain a motion for the minutes of April 14.

MR. HUFF: I move we accept the minutes.

MR. JONES: Second.

CHAIRMAN IVEY: Motion made and seconded. All in favor.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed? Minutes approved for April 14.

Quarterly reports. Brenda, start us off with the program reports, pages 19 through 21.
MS. EMFINGER: I have provided information for you. If you have any questions, I'll be happy to answer those. You'll also find attached some financial statements that the PACT accountant provided.

CHAIRMAN IVEY: Any questions of pages 19, 20, 21?
Investment report, Mr. Pellecchia?

MR. PELLECCHIA: As usual, I'll go through the market overview and give you an idea of what the markets were like during the quarter before we talk about total fund and the individual managers.

If you'll turn to the first section, page 2, you'll see there's a lot of red on this page. The upper chart tells you it was a rough quarter. Markets around the world got off to a slow start in 2005, posting modest losses. The S&P 500 was down 2.16%. The EAFE Index (non-U.S. equity markets) was down about 17 basis points; and fixed income was also in negative territory by 48 basis points. Really, a lot of it was a result of rising oil prices once again and fears of inflation, which caused the U.S. bond market and equity market to be in negative territory.

Economic activity, although still trending positive, had lost some of the momentum during the first three quarters that it had during the last year. And job growth, although steady, remained unspectacular. If you'll look at just the domestic equity market on page 3, you'll see in the little box in the middle of the page that both large and small cap stocks went down significantly. The S&P 500, as we mentioned, was down 2.15% and the S&P 600, which is the small cap stocks, down 2.07%, while mid cap stocks declined fractionally, down 40 basis points.

Value managers outperformed growth managers, which has really been the trend over the last five years, although there were pockets of growth coming back, including the fourth quarter of last year. But value is back in favor this quarter. In terms of sectors, energy, helped by the surging oil prices, turned in its second straight double-digit returns, far surpassing any other sector. Utilities, materials, and consumer staples were also in positive territory. All other sectors posted negative returns with telecom, technology and financials being the worst.

Over the full year, at the bottom of the page, you see that there are some very strong returns. Most of that came in the fourth quarter of '04. Small cap stocks outperformed large cap and value outperformed growth for the full year period. On page 4, looking at the domestic fixed income market, concerns over inflation, the future pace of fed tightening, and also reassessment of credit risk was what weighed down the bond market. Yields increased across most of the yield curve, and it also continued to flatten. Short-term rates were coming up, but longer-term were staying the same pretty much.

As I mentioned, the Aggregate was down 48 basis points. The average core bond manager was slightly ahead at 31 basis points negative. Those that had heavy exposure to credit underperformed. And as you can see, the high yield market underperformed for this quarter.

The credit sector experienced a very difficult quarter. And that was really triggered mainly by the earnings forecast, the negative earnings forecast by General Motors and also investigations into accounting irregularity at AIG, which had a negative effect on really the whole credit market.

At the bottom of the page of the full year return, the affect of rising interest rates has been that the Lehman Aggregate for four quarters now is only up about 1.15 percent. The average core bond manager has outperformed that by about .35 basis points or so but still not great absolute returns. The high yield market was still the place to be for the four quarters ending, up 7 percent.

On page 5 are international equities. The non-U.S. equity market, although mixed, did beat the U.S. Stock Market. As I mentioned, EAFE was down .17 basis points. On average, the U.S. dollar rose a little more than 3 percent against EAFE currencies, which actually dampened the returns for U.S. dollar-based investors. So the actual local investments in non-U.S. stocks were positive, but the currency effect was a negative for U.S. investors. Consistent with trends in recent years, small cap and emerging markets outperformed EAFE while value edged growth. Just like in the U.S., energy was the best sector while technology and telecom were the worst. For the full year, you see EAFE non-U.S. equity markets were pretty strong.

If you flip now to page 9, this is the page that shows you asset allocation snapshot as of the end of the quarter. You'll see that you're right on with large cap equity and small cap equity, and you're overweight international equity by 2 percent. That was at the end of the quarter. We have pulled away some money for payments out of the international equity market, so that should be back to target and slight underweight to fixed income, including a cash allocation of about 1 percent at end of the quarter. Total assets are about $657 million as of the end of March.

Page 10 shows the attribution analysis of the total return for the fund. Unfortunately, the markets were in negative territory, but even the relative return is worse than the actual indices. The actual return was a negative 2.51 percent for the quarter. The target return was a negative 1.53. That return represents what you would've achieved had you been 100 percent invested in index funds at the target weight. And you see that your managers detracted from value. Your active managers lost 1 percent in value, mainly from large cap equity from Peregrine and Bear Stearns, as we'll talk about in a few minutes. And, also, the international equity manager was underperforming during the quarter.

If you recall, Bank of Ireland was replaced with New Star in the international equity area during the quarter, and Bank of Ireland actually had positive performance up until when they managed the money. But then when they gave it over to New Star, New Star had negative performance. But it was in line with the benchmark. So they were both down about 2 percent for the two weeks or so that New Star had it for the quarter, but that dragged the total portfolio of the international equity down versus the benchmark.

Flip to page 12. This is for a longer period of one and a half years. It's good absolute numbers but still poor relative numbers. Your actual return was up 10 percent for one and a half years. Your target return was up 12.5 percent. And your active managers detracted about 2 percent in value, again, most of that coming from large cap equity but a portion from international equity as well.

There was a positive asset allocation effect of .19 basis points. That's just the residual of being under or overweight various asset classes, but that was not by any tactical measure. It was just a fallout.

If you go to page 14, this is how your performance has compared against other public fund sponsors in our database. A couple of things here: Number one, your recent performance over the three and five year period has been poor. That is a reflection of the fact of two things. One is that you have higher exposure to equities than a lot of plans in this database over the last five years. You have 70 percent equity. But, also, your managers have underperformed during this time period as well. And that is a poor reflection given the bottom quartile performance for the five year period. Over the 10 and 14 and a quarter year periods since the PACT Fund has been in existence, you have had good absolute return numbers. You're in the middle of the database, 52nd percentile, 10 years; 42nd percentile, 14 and a quarter years. And the 9.84 percent is ahead of your actuarial expected return for the full time period.

If you flip now to the next section, the page that we have added to show who your managers are, what the benchmark is and the inception date. You'll see you're obviously paying more in active management fees, and you're paying more in small cap and international.

If you'll flip now two sections ahead to page 25, this is the performance of the individual managers of your portfolio. Starting on page 25 is the performance of Peregrine, which is your large cap growth manager. They've been investing for you for about five and three-quarter years. They had better performance in the early years and have underperformed recently. This last quarter was no exception. They were down 6 and a half percent. Russell 1000 growth was down 4 percent. Main reasons for underperformance were that Peregrine is a growth manager, they are going to have little exposure to utilities, material, and energy and overweight to tech and financials, which were two sectors that underperformed. Also, two of their largest holdings were E-Bay and AIG, which were both down significantly. E-Bay was down about 35 percent for the quarter. AIG was down about 15 percent for the quarter. E-Bay has come back significantly since the end of the quarter, AIG not so much. Hopefully, we'll see better performance this quarter on Peregrine. There's been a lot of discussion at the investment committee level about this manager. The recent performance has not been good on a relative basis. The last two years, they're up 13 percent, but they're trailing the benchmark. The longer-term number is about median but ahead of the benchmark. This is a high-quality, large cap growth manager that has all the people in place that were there when you hired them. Philosophy has not changed. Large growth stocks have been out of favor. And Callan still has a pretty good, high regard for Peregrine, but their performance continues to be mediocre. And, obviously, we'd like to see better performance, but we're supporting Peregrine. You are doing an RFP for this asset class, mainly because their contract is up; but we will also look at managers and how they compare to Peregrine and they may be replaced.

If you flip to page 30, this is the performance of Rhumbline, which is your index manager. Now, there are a couple things playing through here with Rhumbline. Number one, they're an index manager so they're designed to mimic the benchmark, the index that their bogey is. Their bogey is the Russell Top 200 stocks, which is the largest capitalization stocks in the universe. And they have done an excellent job of tracking that benchmark. Over time, you'll see that it's very close to the benchmark, slightly ahead in some periods, slightly below in others, but for the most part has tracked it very closely. The reason why they are showing in the bottom quartile now for the five and three-quarter periods is two things. Number one is that active management over the last couple of years has paid off ahead of index fund. And, also, lower cap stocks have performed higher than higher cap stocks. And so with the Russell 200 being the benchmark here, it is the highest of the highest cap. We have had discussions about this before about whether it's the proper benchmark for Rhumbline to be benchmarking themselves against. And I concurred with your previous consultant at the time because the 200 gave you exposure to the largest cap stocks where you had Fox, Peregrine, and your small cap managers having the more lower cap. And so you needed that higher cap exposure. Since Fox has been replaced with Bear Stearns, Bear Stearns is not as mid-cappy as Fox used to be. Peregrine is about where they were. The small cap managers that you replaced Citigroup with tend to be a little bit higher cap. Earnest plays in the higher range of the small cap area. I plan to review other index funds for your index manager.
There's two things playing through here. One is that given your total portfolio, you probably can move now from a Russell 200, which is the highest cap, to an S&P 500, which just gives you a little bit more exposure to lower cap. But it's still a very large cap. The one worry that I have is that if you do it right now, you've just experienced the worst underperformance from the large cap that you've had in the last five years. We're seeing signs of large cap beginning to outperform. And so if you move away from the largest cap when you could've experienced turnaround.

MR. HUFF: Well, let me address that because since 1999, all the money guys have been saying that large cap is about to start outperforming small cap. And each year for the last six years, they've been wrong, and they're wrong again this year. And so why would we think just because, historically, it appears it's time for the large cap to improve performance; when, in fact, it hadn't been the case. I agree with you that, personally, I think that when we send our request for proposal it should be based on an index fund mimicking -- not even necessarily the S&P 500, but maybe even the Wilshire 5000 because I think that we're really dealing with just the issue with the large cap. They are just too big. I think we should consider reviewing the index. In addition to that, On page 16, I noticed that everything is in the red with equities except the small cap on a longer-term basis. Yet we're talking about changing the asset allocations to increase performance; but the one asset class that over the long term continues to outperform, we're still not changing it, which is small cap. We're still at 9 percent of small cap.

I guess my question to you, Bud, why are we not considering increasing the asset weight on small caps?

MR. PELLECCHIA: When we put together a portfolio of domestic equity, we want your portfolio to not have any extreme bias or biases one way or another versus the broad market. That's why we have combination of growth managers and combination of value managers. And it's also why we have a combination of large cap and small cap. If you were to look at a broad benchmark like the Wilshire 5000 or the Russell 3000, the exposure to small and mid cap stocks is about 20 percent of the total domestic equity portfolio, which is about where yours is if you take 8 percent of 46. If you take the percentage of small cap versus large cap, it's about 20 percent of the total domestic equity portfolio. And that's what the broad market looks like, the Russell 3000 or the Wilshire 5000. And so if you're going to have it overweight or exposure to small cap, then you are taking on a bet or bias versus the broad market.
I think that small and large move in and out of favor, and you've just had a very big run in small cap stocks. And I think that the tide is about to turn to large cap.

MR. HUFF: You made a big point about weightings. Yet we just went through the analysis of Bear Stearns' underperformance. For instance, the reason for their underperformance is that they're overweight in the wrong sectors. And so it's interesting that all our portfolio managers regularly overweight and underweight sectors against benchmarks. Yet, we, on an asset class level, saying, well, we can't overweight small cap; but all the money, though, is typically either underweight or overweight.

MR. PELLECCHIA: My response to that is, I'm not smart enough to know when small cap is going to outperform large cap or vice versa. And I'm suggesting to you that you're better off being invested in both of those areas at the market weight.

MR. HUFF: Now, what's the market weight, then, for international equity? Currently, before any changes, are we at the weight; or are we overweight or underweight?

MR. PELLECCHIA: If you were to look at the world market cap, about 45 percent of the capitalization comes from outside the United States. We are significantly underweight of that. And I just think that you have a lot more playing through in the international markets that you can't get up to that big of a weight.

DR. MALONE: Madame Chair, I have an even more basic question. This Board, in the last three years, made a lot of changes with the various managers in reallocating to relative strengths. I'm not so sure we've done the same thing for benchmarks. Is there a systematic process by which, when we make these discussions on fund managers, that we also don't address the benchmark itself because it would seem like we might even be asking a manager to do something that may not -- well, for instance, the Russell 200 is not reflective of what our changes in our allocation structure is getting at. Are we artificially developing some case for artificial expansions or decreases by not looking at that metric?

MR. PELLECCHIA: If you go to page 9 at the very bottom of the page, there is a line that shows what the current quarter target; and that's what it's been for a good amount of years now. Based on asset allocation, your benchmark target is 46 percent Russell 1000, which is large cap stocks; 36 Lehman Ag, which is fixed income; 15 percent EAFE, which is international equity; and 9 percent Russell 2000, which is small cap. That is a true bogey of what you're invested in.

MR. HUFF: Here's my point. And I disagree with what you are saying is going in macro view. The macro view, over the last six or seven years -- and it's continuing -- is that our economy and the world's economy is being driven by smaller firms that are some point with a startup in these smaller firms. Most of the new employment is coming from smaller firms, the growth of smaller firms. Everything is smaller firms. You look at the large firms, the way they're putting all their numbers. They're laying people off. They are not growing. They're buying back stock, which means they're not going to grow. At best we get a minimum return. And I think, fundamentally, that just to say we think large cap is going to catch up. Well, people have been saying that for the last six years, Bud. At what point do we realize that you've got to see change? But I just want Callan on record saying that they agree with the asset allocation. And what you just said is they agree that 9 percent is the proper and right small cap asset allocation. And that's you're recommendation, right?

MR. PELLECCHIA: That is. And I wanted to point out on page 16 that the Russell 1000, which is the large cap universe, because that's the only one we have here, or if you looked at the Russell Top 200 versus the Russell 2000 over 14 and a quarter years, yes, there is a premium for small cap stocks. If we looked at the volatility of small stocks, I'm sure it would be a lot higher than large cap stocks. And this is coming at the end of, what you said, is six years of great out performance by small cap. If we looked at the long-term numbers, small cap would not look as great.
Again, my recommendation is based on we are suggesting you don't want to look different than the total domestic equity market. The Board may decide to overweight small cap. I’m suggesting you don’t.

MR. HUFF: Callan said we shouldn't change that. You know, I thought maybe we should, but he said we shouldn't. And that's his job to be on top of this. That was my question. At what point do we try to pick up some performance by putting more money in small cap? But I defer to our consultant.

DR. MALONE: Well, I'll just speak for another Board member. I listened to what Willie is saying. And I guarantee you, within this next year, I'll pay a lot more attention to that than maybe I would have ordinarily. And I think that's probably a benefit of this discussion. On the other hand, I defer to our consultant on it, but it's worthy certainly of watching more closely. But I have confidence in our consultant.

CHAIRMAN IVEY: This is good healthy discussion.

MR. PELLECCHIA: If you now turn to page 33 of the report, the performance of Bear Stearns. This is your large cap value manager who replaced Fox about three quarters ago, and they underperformed for the quarter. They're down 1.90 percent, so the value index was up about .09 basis points. And that put them at the bottom quartile, 82nd percentile for the quarter. Bear Stearns had exposure to AIG, Home Depot. That was two specific stocks that hurt their portfolio. Also, they had underweights in sectors that did well, utilities and material. And that explained their poor relative performance for the quarter. However, this three-quarter year period since we've hired them, they're now down 500 basis points in the 76th percentile. Definitely not good performance. I can't defend the numbers. What I can say is that three-quarters of a year is not a long enough period to evaluate a manager. When we looked at their performance when we hired them, they were consistently top quartile in all periods. My hope is that this is a performance blimp and they will come back. We still feel good about Bear Stearns, but this three-quarter year performance has not been good.

Page 36 is the performance of Earnest Partners, which is your small cap value manager, hired around the same time as Bear Stearns. They have very good performance on a relative basis. The value benchmark, small cap value was down about 4 percent, but they were still in positive territory. They had a slight overweight to energy, including two stocks that performed very well, Cabot Oil and Gas which was up 24 percent, Chesapeake Energy which was up 33 percent. Their very strong performance falls absolute and relative versus the benchmark and the peer group since inception, 4th percentile.

On the small growth side, you had a change in managers during the quarter. We moved from State Street to Turner. We don't have a full quarter performance for Turner, so that's why we don't have a performance sheet for them. But they are your new small cap growth manager.

Turning to the next section is page 40. This is the performance on this page of AmSouth. They are fixed income manager that's normally more defensive, more conservative over your other manager Sterne Agee. They were slightly below the benchmark, .03 basis points versus Lehman Aggregate. But that put them in the bottom quartile. You can see that the playing field of all managers for the quarter was pretty condensed. So a couple of basis points would have made a big difference in ranking. The two year number, though, is disappointing. Their longer-term performance has been very good, top quartile over five plus years. The lower duration helped for the quarter, but the increased exposure to credit hurt during the quarter. Both your fixed income managers have contracts expiring. We are doing an RFP and looking for alternatives. There was also discussion at the investment committee meeting about other ways to invest in fixed income, including non-benchmark sectors, high yield and TIPS. That will be part of the investment committee report. The last two years' performance is underwhelming, but the longer-term performance for AmSouth has been good.

Page 46 is the performance of Sterne Agee. They tend to be more aggressive manager than AmSouth. They're longer duration than the index, which is really what hurt performance for this past quarter. It is down about 32 basis points versus the index, which put them at the bottom of the charts. However, all their periods of performance have been top quartile. And I would suspect, unless they change their duration, that that longer duration helped them in this last two months when rates actually came down. So good performance here, strong performance over all periods except for last quarter. That concludes my report.

CHAIRMAN IVEY: Thank you, Bud. And members of the Board, you know, we're all committed to having high performance for the program; and we're all devoted to finding the best strategies to get there.

Investment Committee report. Let's take Item III.B., Investment Committee report, Mr. Jones.

MR. JONES: Thank you, Madame Chairman. We had a good meeting this morning, reviewed several topics. We reviewed the underperforming managers, basically, four of them. Made comments and discussion on that. We will be interviewing because of contracts terminating at our August meeting for domestic equity managers and domestic fixed income managers. We had much discussion about the alternative asset classes. I will ask Bud once I make this recommendation to explain a little more in detail of what we want to do. But, basically, we want to make a change in the investment policy to include high yield core plus and TIP in our asset classes. And, also, to change our asset allocation to a Mix 3 on page 16 of the handout. . And I'll ask Bud to review.

MR. PELLECCHIA: The pleasure of the Board in the long-term planning committee was that we need to look at alternative mixes of asset classes that can get us closer to our actuarial expected rate of return. And the current asset mix that we have, based on our projections of those capital markets on page 16, would get you about a 7.8 percent expected return over the next five years. We're looking for ways to improve that expected return, and we're looking at ways where we can add other potential asset classes to get us there. We eliminated some of the non-liquid asset classes, such as real estate and private equity. But we did include other parts of fixed income, such as high yield and TIPS. And, basically, we have come up with a more efficient mix which gets you more exposure to equities in general, increases your expected return, and does not increase your standard deviation of risk significantly. We would recommend that we go to a Mix 3 which would give you a slightly increased expected return with a slightly increased expected risk, but it would allow us to have a potential for out performance going forward because we are looking for any bit of incremental return we can get. What it would do is slightly decrease domestic equity by 4 percent, moving large cap down from 46 to 43; small cap down from 9 to 8; but it would increase international equity from 15 to 21. What it would do on the fixed income side would slightly reduce it from a total domestic fixed income of 30 percent down to 28 percent, but it introduces two subsets of the fixed income which is high yield and TIPS.
We also had discussion about, how you implement getting exposure to high yield and TIPS. And one of the ways that you can do that -- and I think is a more beneficial and least disruptive to your current portfolio and also one that is more opportunistic -- is to allow a fixed income manager to invest opportunistically in sectors that are not part of the benchmark like high yield. And that's what they call a core plus manager. A core plus manager is a fixed income manager benchmarked against the Lehman Aggregate, just like your regular fixed income manager. But it opportunistically invests in high yield, non-dollar bonds, emerging market debt. And so that 9 percent exposure, we would suggest you get through a core plus manager. The 9 percent exposure to TIPS, however, would require a special mandate for a TIPS manager. And the recommendation of the investment committee would be to add that asset class as a stand-alone; whereas, high yield would come in a core plus mandate.
The current RFP that's out there for fixed income does contain language to ask for information on both core and core plus type managers. So it's not like we have to do a new RFP for that part of it, but we would have to do a new RFP to get the exposure to TIPS.

CHAIRMAN IVEY: Bud, tell us what TIPS stands for.

MR. PELLECCHIA: Treasury Inflation Protection Securities. And, basically, it is a treasury bond backed by the government, but it is linked to the CPI, linked to inflation. And it's recalculated every year based on the CPI number. And so it's a better investment versus nominal bonds when inflation is rising. You are guaranteed your principal even if inflation goes down, even if there is deflation. So you don't lose on that part. There are times, though, in a total return perspective, nominal bonds will outperform TIPS; but, still, with inflation to go up and the benefits of diversification by TIPS, if you looked at the correlation numbers of TIPS, even versus regular domestic fixed income, there are certainly greater advantages on diversification level in reducing risk. And, basically, by adding TIPS, you have the leeway to increase your exposure to equity without significantly increasing your risk.

MR. JONES: I'd like to make that recommendation in the form of a motion.

MR. HUFF: I thought you were recommending that we change investment policy. Are you recommending that we accept this Mix 3?

MR. JONES: Yes.
Maybe I need to clarify the motion. The motion is to change the investment policy to include high yield, core plus, and TIP asset classes, and that we change the asset allocation to the percentages that's shown in Mix 3.

MR. HUFF: I thought what we did in investment committee was change the domestic fixed income from 30% to 28%, as opposed to the individual class breakdowns.
CHAIRMAN IVEY: So let's try the motion one more time.

MR. JONES: Motion is to include core plus and TIPS in our investment policy or asset classes and to change the asset allocation to show that large cap would be reduced by 3 percent, small cap by 1 percent, international equity plus 6 percent, domestic fixed income minus 2 percent of the current policy.

CHAIRMAN IVEY: Is there a second?

DR. McGEE: Second.

CHAIRMAN IVEY: DR. McGee has made the second. More discussion?

MR. HUFF: Are we recommending reducing small cap by 1 percent? I oppose that.

MR. PELLECCHIA: Yes. It's going down by a percent. We could leave small cap equity at 9 percent.

MR. JONES: And reduce large cap by 4 percent?

MR. PELLECCHIA: Right.

DR. McGEE: Second will agree to the change.

Dr. MALONE: So, again, what are our numbers?

MR. PELLECCHIA: 42 large cap, 9 percent small cap, 21 percent international, 28 percent fixed income.

CHAIRMAN IVEY: Any other discussion? All in favor of the motion say aye.

(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed? Motion carries. So we'll change it in the investment policy.

MR. JONES: The only other motion that we have at this time would be to move that we do an RFP for a TIPS manager since that is listed as an asset class of its own.

DR. McGEE: Second.

CHAIRMAN IVEY: Second to the motion. Any discussion? All in favor vote by saying aye. (Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed? Motion carries.

MR. JONES: The only question I would have on that, would that RFP be done to review those at the August meeting, or would it have to be the next meeting after that?

MR. PELLECCHIA: The next meeting.

MR. JONES: That's all of our report.

DR. McGEE: Madame Chairman, on pages 22 and 23 of the minutes, just a couple of typos. Could we change my name?

CHAIRMAN IVEY: I see the correction. Thank you. All right.

PACT marketing, as you all know, the last Board meeting, we agreed that we would set the price for the contract roughly at 21,000 for an infant. And we said we'd open up, then, enrollment period for four months and start an intensive marketing effort. Anthony Leigh quarterbacks that effort from the office. Give us your report.

MR. LEIGH: And we're in the process of putting into motion the plan that we had presented and discussed at the last Board meeting. We had one major snag. We immediately submitted the brochure with the new pricing to the Office of Printing and Publications, which the governor has since eliminated. Only yesterday did we find out from Printing and Publications that they were not going to be able to produce the brochure for us. We have already received permission from the State Purchasing office to contract with EBSCO Media for them to produce the brochure. We expect to have a PDF copy of the brochure available on our web site today, as well as information about the application, but the hard copy of the brochure will not be available for another ten days to two weeks. So as soon as we receive the brochures, we can put into motion so much more of the marketing plan.

We've already filmed our commercial, which is currently running statewide on cable, on CNN, FOX News Channel, Lifetime, and ESPN. We're also continuing to have discussions with Alabama and Auburn about the radio sponsorship that we've done for the last two years as well. Any questions?

DR. McGEE: A comment. Really outstanding piece in the Dothan Eagle. It was a marvelous piece. My compliments.

CHAIRMAN IVEY: They really did a nice job.

DR. McGEE: It really is. It makes the point so well. And it's just proof of how good the program is.

CHAIRMAN IVEY: The recent articles for your review, 25 through 34. Now, we come to trading analysis. Tara from Abel Noser. Page 35 through 48.

MS. IHAZ: Thank you, Madame Chairman. Brief background of Able Noser. We are one of your commission recapture brokers as well as providing you with transaction costs analysis. We were founded back in 1975 and in 1986 were hired by the Department of Labor to do a trial run and see if there was a way to measure transaction costs. We have since become the largest provider of the service domestically. We measure for about 550 pension plans, which include about 750 money managers. So our universe is roughly about $4 trillion globally, 3 trillion domestically.
And when we are looking at transaction analysis, we are looking at two components, which are the commission and the execution. Commission is easy enough to measure. And the execution, the benchmark that we use is the volume weighted average price for a trade day. And we get your confirms from your custodian, and we take that data and break it down and then compare all of your managers and the brokers they use to our entire universe. It's really to make sure that you're getting a fair and equal price. You will not always get the best, but you don't always want to be the worst. And so this is just to make sure you're in line with all of your peer groups. And it's really a way to look at actual pattern building.
The report that I have for you is first quarter. You had some transitions going on during that time period. So just as Bud stated, it's kind of hard for me to see if your managers will continue to trade as well as they had been in our reports going forward. But you do receive this on a quarterly basis, so we'll see if any pattern starts to build.

CHAIRMAN IVEY: Page 36 in your materials.

MS. IHAZ: This is what we call a historical summary. And we have been measuring for you all since I think May of last year. And the way it's broken down is the first column is the confirms that you received, which are actual tickets of the trades. The second column is the shares that we've measured. The next one is the principal we looked at, and we have it in dollars and in cents per share.
Under commission cost, the cents per share column, you will see that it wasn't one penny. I think that was back 5/26/04 to 6/29/04. You had an event during that time period. So I think that that is what brought the commissions down. And going forward, your commission -- this is reading from the bottom upwards -- they went 4.5 cents, then the fourth quarter 4.3 cents. And then for the first quarter, your commission went down to 2.2. And the reason that occurred is because you did have transitions that were done at a lower commission than normal for you all when you had transitioned Bear and Turner. The column next to that is your trade cost, which is your execution cost. And, again, that is your manager's cost -- the volume weighted average price for a trade day. And going back again to that 5/26 to 6/29/04 period, it was 1.9 cents a share. It went to 2.5. It went to 1.8, and for the first quarter of this year, it is 0.9 cents of a penny. And, again, to the right of that is the total cost. And leaving off that May to June period of '04, just looking from the second half of '04, going forward under total transaction costs, you can see that the total cost has gone down. It was at seven cents back in the third quarter of '04. It went down to 6.1 during the fourth quarter. And for the first quarter, it went down to 3.1. And, again,

I don't know if this will hold true going forward because the first quarter you had a special event going on which brought the total cost down.
The good news is, though, that this 3.1 cost down here on the bottom right, if you look right here in the middle, the total cost for every other plan that we look at in every other manager is 4.8. So you're doing 1.7 cents better than our universe is looking at right now.

MR. PELLECCHIA: Does this include international trade?

MS. IHAZ: This is only domestic equity. Now, this, of course, will continue to build. As we measure for you, this historical summary will continue to grow, and it's just an easy way to get a snapshot of how changes that you have made as far as allocations have kind of affected your trading cost.
The other page, which is just the quick one-page summary, the transaction cost analysis summary, this we typically send along with our report. And really what this tells you is in the different components of the trading cost, which is the average commission and execution, how you faired versus the universe that we look at. So top tells you how shares you've traded for the quarter, which is 3,652,000 shares, and the principal that we looked at, which is 97,754,000. Below that, it tells your average commissions broken down by list and over-the-counter. And it shows that your plan, when they paid out commissions on the listed side, paid out 2.69 cents per share. To the right of that is what the universe paid out. Below that on over-the-counter, you paid out 1.75. The universe is at 3.7. So in total, you're at 2.21 for commissions; universe is at 3.86. So you're beating them in commission cost. And it's the same thing with your average execution. Here, you're losing .88 cents to the volume weighted average price. When all other managers in our universe trade, they're losing about a penny to volume weighted average price. So in total, which is total commission and execution, you're paying out and/or your execution cost is 3.09 cents per share. The universe is at 4.76. And underneath that, it tells you that the total cost for our universe is 4.76. So your total cost of 3.09 placed you at or around the 25th percentile in our universe.

Now, the attached report that I have, which says Alabama PACT, Trading Report, Executive Summary for the first quarter, it is a shortened version of the entire report that is provided for you all. The entire report has individual manager booklets with every single broker that they have traded with individually. This one kind of gives you a general overview of what I'm going over in every quarter. The first page, page 1, is a trading profile. Alabama PACT numbers are up top. The universe is on the bottom. And, again, this tells me the first column is the confirms that I have received from your custodian, 826 confirms or tickets. I have measured 3,652,000 shares, looked at $97,754,000. And the average price per share bought or sold, you are 26.77. So this will kind of give me a general idea of where you've compared to where everybody else in our universe had traded. And on the bottom, you can see the numbers of the Abel Noser universe, how many confirms, shares, and dollars we look at in total. And the average price per share in our universe is 27.83. This is as basic as this measurement gets. It kind of brings it down from a bird's eye view and comes down to finer detail.
And the pie chart just tells you where the majority of your dollars were traded. You had 41.5 percent trading in over-the-counter stocks versus the universe that was 28.8 percent and the 58.5 in listed versus our universe which is 71.2.
Now, the next page is your commission dollars that are paid out. And, again, gives it to you the average dollar per ticket and the total dollars that were paid out. The middle is your commissions that were paid out in cents per

share, which we went over with the summary that we had. So, again, 2.1 which is the total column on the center bottom is what you paid out. The universe pays out 3.86. So you beat that universe in commissions by 1.64 cents per share. And that number, that 2.21 on the bottom right-hand chart which is here, if you go to combined, the 2.21 places you again probably around the 20th percentile in our universe for commissions.

The next page is your execution. And if you read the bar at the top, the title, it will tell what this is. It's your cost versus the volume weighted average price of the trade day. That .88 under your execution cost is what your managers are losing to the daily volume weighted average price. To the right of that is what other managers in our universe are losing to that volume weighted average price. So you're beating it by a tenth of a penny. And that .88 should put you right at about the 45th percentile for execution cost. And the next page is a combination of the two. This is your commission with your execution, 3.09 versus 4.76. Again, you're beating the total cost by 1.66 cents per share. Overall, this 3.09, again, if you look at that bottom right-hand column, you're actually in about the 20th percentile for the universe -- not the 25th, closer to the 20th.

Now, this is the executive summary. Going back into the report is the detailed portion. So if you'll turn page, that's our trading profile and actually says page 1. It's a black and white page. This says everything we went through in the executive summary. But on the left-hand side, you can see it now in the buy-and-sell side. So, mainly, we've gone through all the commissions that were paid out. We've gone through the execution cost, add the two together for the total, and then versus the benchmark. This is the first thing I look at, the versus the benchmark column, to see if there is any negative number, was it caused from the buy-or-sell side. You're positive across the board. So you really beat the benchmark in every aspect of the trading, on listed side, over-the-counter, buying, and selling. So very good trading for the first quarter.

Now, the next page is where we break down your managers. It's principal weighted. The largest trading manager will be up top, which is Turner Investment Partners. The first column gives the amount of shares they traded. Then it gives the amount of principal and the percentage that they traded for the entire plan.

The next column over is their commissions. Now, just looking up and down pretty quickly, the majority of them are below the average right now. Turner is very low. And that is due to the program that they had because they did it through Abel Noser. And we gave them a low rate when they traded with us, which brought their entire commissions down. Bear Stearns is at 3.66, 4.57 Peregrine, and 4.99 Earnest. The average is below 4. No one is really off-the-charts high, but the average keeps going down. So if the average of the universe keeps going down and they stay where they are, eventually, you might want to just bring it up to them that they may be able to bring it down a tiny bit. The execution cost to the right of that, the only one that looked a tiny bit expensive because if you look at Turner and you look at you, your average is .88 which is below the universe. Turner is below that at .84 which is the center column going down. Bear Stearns had a little bit of cost. They're at 2.48. But what I want to point out is, there is another document I sent to you along with everything else. And that would be the Manager Day Length Style VWAPs. Do you guys have this is your package?

MR. PELLECCHIA: Page 38 of this packet.

MS. IHAZ: It's kind of unfair to measure us being, let's say, we're a value manager against a growth manager. Our costs are not going to be the same. We have different methods of trading. Some of us have momentum. Some of us

are counter or neural. So in our universe, we broke it out so we can measure them against their peer group. So if you'll look here again at Bear Stearns, their execution cost is 2.48. And you look to the right under the versus open column, they trade with a tiny bit of momentum off the buy side, which is kind of like sitting there and waiting once the market opens and seeing what the market is going to do. And if the stock is ripping, they may wait 'til 11 o'clock during the day to jump in. So if I measure versus a whole day, it looks like they missed the best prices from 9:30 to 11 o'clock. But if you look at them from 11 to the close and the market kept going up, then it looks like they did a good job, which is why we have this sheet.
So Bear Sterns' large cap value, if you look at their total cost of 2.8 and then you look over here at large cap value, you'll see that their peer group that trades with momentum is at 2.63. So versus their period, they're right in line with every other large cap manager that we look at. And that's what this page is for, to give them a fairer measure. Now, everybody else looks fine. Execution cost is phenomenal and the same thing with Earnest Partners. The next page is the broker summary by exchange. One of the most important reasons to measure is if you do have directed brokerages or recapture in place because you want to make sure that whoever is in the program is not adversely affecting your execution costs because you can be getting 75 percent on 6 cent trade. And you usually double that in execution to have that brokerage in your programs.

The good news is the two brokers you have, which are Abel Noser and BNY, are doing a job for you. So they're keeping the cost under the average in the universe. Your top broker for the quarter was Abel Noser, and that is because we did the transition for you for the first quarter. We did 55 percent of your trading. The average commission was 1.19 cents per shares. And to the right of that, our execution is .64, which is under the universe average again of a penny. Credit Suisse First Boston has a little bit of cost there, the 2.37. The reason they have that is because of Bear Sterns trading with them. Usually, if a manager had a little bit higher cost, the broker they tend to use the most will kind of mirror their imagine. But BNY, the fourth broker down from the top, also did fantastic. They're positive versus the volume weighted average price. So they also did very good with execution.

Normally, I focus on the top five to seven brokers because that's where the majority of trading is taking place. But overall for the quarter, your plan did a spectacular job. I pretty much know that the event that took place, the transition is a large part of why it looks this way. So we'll see going forward if the costs goes up a little bit, then your commission goes up a little bit. But, overall, very good.

CHAIRMAN IVEY: Thank you very much. That's a very informative summary. I'm glad we're holding cost down.

MS. IHAZ: You are holding cost down, and you're holding cost down better than most for the first quarter.

MR. PELLECCHIA: You said these services just lend the domestic equity, but you can do it on domestic fixed?

MS. IHAZ: We just pulled out our fixed income product. I have yet to see it, but we're kind of offering it mainly for our existing clients to just send as stated because we're trying to build a universe up. So, yes, we can do it. And we can also do it for international.

MR. PELLECCHIA: And the fee, does it incrementally go up?

MS. IHAZ: The international will not. We're talking about international activity equity. Now, that comes along with commission recapture and directed brokerage. The fixed income will more than likely have a fee to it, which again I'm not sure what that's going to be. It depends on how often you'd like to see the report or what's entailed with the report. I can tell you this report is going to be changing for you probably in the next three to six months. We are going to a paperless format, drill down a drag and drop kind of way of looking at it. And it's actually fascinating. We only were offering it to money managers and sponsors that had internally managed equities. And you can have probably about seven more different measures with that new product. So instead of us just using the volume weighted average price for the trade day, we can incorporate more measures. And instead of just seeing a couple of trades on here that may have had cost impact, you can see every single trade that was done for the quarter. And you can break out your recapture brokers and measure them separately. You can remove an event. If you had an event going on that took a week's period of time during the quarter and you think it affected the numbers, I could just pull it out. And I can measure it without the event in there. There's a lot of different things you can do to play with it. And there's no increase for that either. It's just the way everything is moving.

DR. MALONE: This is great data. This adds another dimension to our ability to look at the total scope of things. I thank you.

CHAIRMAN IVEY: Thank you very much.

MS. IHAZ: You're welcome.

Chairman Ivey: Decision items for the Board, page 49 and 50, regarding the contract pricing for '05. Certainly, we adopted the contract pricing at the previous meeting. Legal counsel is with us, Mike Manasco, to respond to any details. And if you've read the proposed contract resolution before you, following the called staff meeting, the staff realized that the lump sum seventh grade pricing was $54 less than the sixth grade pricing, and the nine grade pricing was $109 less than the eighth grade pricing. And the staff certainly brought it to my attention, and the actuary explained to us that those numbers occurred as a mathematical function between the assumption for investment return and the assumption for tuition increases. So long story short, with the Treasurer, having general discretionary operational decision-making authority provided by the Board, made pricing adjustments to equalize between pricing between the earlier and later enrollment years for the lump-sum payment. So, therein is the reason for the resolution before you, and it requires that the Board would ratify the aforementioned adjustments for the 2005 PACT contract pricing. If you concur with those changes, we'd ask for a motion to adopt.

MR. HUFF: I move we accept the changes.

CHAIRMAN IVEY: Is there a second?

MR. JONES: Second.

CHAIRMAN IVEY: Is there discussion? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: Opposed say nay. Motion carries. Resolution adopted. Then on page 51, consideration of a second resolution. You recall that JPMorganChase, Bank of New York, and Wachovia made presentations at our December meeting to provide custodial services. And the Board selected JPMorganChase. During negotiations with JPMorgan, it became clear that they could not agree with requirements of this Board. And, certainly, Legal Counsel Manasco worked diligently with them. It became clear that we needed to terminate negotiations. And so we went to the second preferred manager, and we're in the process of negotiating with Bank of New York. And this resolution addresses that and also says that if for some reason the Bank of New York cannot be negotiated, we would go to the third preferred, which was Wachovia. This resolution would authorize the Treasurer to negotiate and execute a contract with the Bank of New York for trust fund custodial services and securities lending for PACT for a five-year period and is heretofore authorized by the Board and noted in the request for proposals.

DR. MALONE: Move approval.

CHAIRMAN IVEY: Is there a second?

MR. HUFF: Second.

CHAIRMAN IVEY: Any discussion?

MR. HUFF: I just have a question. Why is it you have to come back to us to negotiate for the best interest of the PACT? Why is it you have to get our approval?

CHAIRMAN IVEY: Because the Board's last instruction was you chose JPMorgan. So it's very much in the Board's interest that you be made aware of the need to go to the second selection. And, therefore, this resolution would recognize that action with your approval.

MS. STORY: In the future, resolutions approved by the Board will include provisions to negotiate with a second or third vendor should negotiations not be successful with the first selection.

CHAIRMAN IVEY: Motion carried.

All right. Our next meeting is August 24. Ladies and gentleman of the Board, it will be a long meeting as we interview different managers. Any other matters before the Board of PACT? If not, we'll declare the Board adjourned. We'll take a brief recess and reconvene as the Board for the Higher Education 529 Program.

(Meeting adjourned at 12:13 p.m.)

CHAIRMAN IVEY: Opposed say nay. Motion carries. Resolution adopted. Then on page 51, consideration of a second resolution. You recall that JPMorganChase, Bank of New York, and Wachovia made presentations at our December meeting to provide custodial services. And the Board selected JPMorganChase. During negotiations with JPMorgan, it became clear that they could not agree with requirements of this Board. And, certainly, Legal Counsel Manasco worked diligently with them. It became clear that we needed to terminate negotiations. And so we went to the second preferred manager, and we're in the process of negotiating with Bank of New York. And this resolution addresses that and also says that if for some reason the Bank of New York cannot be negotiated, we would go to the third preferred, which was Wachovia. This resolution would authorize the Treasurer to negotiate and execute a contract with the Bank of New York for trust fund custodial services and securities lending for PACT for a five-year period and is heretofore authorized by the Board and noted in the request for proposals.

DR. MALONE: Move approval.

CHAIRMAN IVEY: Is there a second?

MR. HUFF: Second.

CHAIRMAN IVEY: Any discussion?

MR. HUFF: I just have a question. Why is it you have to come back to us to negotiate for the best interest of the PACT? Why is it you have to get our approval?

CHAIRMAN IVEY: Because the Board's last instruction was you chose JPMorgan. So it's very much in the Board's interest that you be made aware of the need to go to the second selection. And, therefore, this resolution would recognize that action with your approval.

MS. STORY: In the future, resolutions approved by the Board will include provisions to negotiate with a second or third vendor should negotiations not be successful with the first selection.

CHAIRMAN IVEY: Motion carried.

All right. Our next meeting is August 24. Ladies and gentleman of the Board, it will be a long meeting as we interview different managers. Any other matters before the Board of PACT? If not, we'll declare the Board adjourned. We'll take a brief recess and reconvene as the Board for the Higher Education 529 Program.

(Meeting adjourned at 12:13 p.m.)

Kay Ivey

Kay Ivey, Chairman

Adopted Resolution by the

PACT Board of Trustees at its meeting on May 25, 2005

Topic: 2005 PACT Contract Pricing

Whereas, the Board of Trustees is responsible for the approval of contract pricing for each enrollment period; and,

Whereas, the Board of Trustees at the called meeting on April 14, 2005, discussed pricing scenarios prepared by the Actuary, specifically discussing the assumptions, and subsequently adopted 2005 PACT Contract pricing based on assumptions believed to be the most applicable and accurate; and,

Whereas, following the called meeting, the staff recognized the lump sum pricing anomalies that the 7th grade pricing was $54 less than the 6th grade pricing and the 9th grade pricing was $109 less that the 8th grade pricing; and discussed this with the Treasurer; and,

Whereas, the five (5) year pricing for the 6th grade was $2 more than the 5 year pricing for the 7th grade; and,

Whereas, conceptually from a practical view, contract pricing in a later enrollment year should not be less than the price in an earlier enrollment year; and

Whereas, the PACT Actuary explained that the referenced pricing occurred as a mathematical function between the assumption for investment return and the assumption for tuition increases over time that accumulated at their intersection point and that the calculations are actuarially accurate; and,

Whereas, the Treasurer has general discretionary operational decision making authority provided by the Board; and as a part thereof with staff recommendation, the Treasurer made pricing adjustments to equalize the pricing between the earlier and later enrollment years for lump sum payment and for the five (5) year pricing.

Therefore, Be It Resolved, that the Board does hereby ratify the aforementioned adjustments for the 2005 Alabama PACT Contract Pricing.

AGENDA ITEM IV. B.

Adopted Resolution by the PACT Board of Trustees at its meeting on May 25, 2005

Topic: Selection of PACT Trust Fund Custodian

Whereas, the Board of Trustees ("Board") issued and received ten Requests for Proposals for Trust Fund Custodial Services on October 7, 2004; and

Whereas, JPMorganChase, Bank of New York and Wachovia Bank made presentations at the regular meeting on December 8, 2004 and the Board selected JPMorganChase; and

Whereas, Treasury staff undertook and participated in substantial and lengthy negotiations with JPMorganChase from February, 2005 through May 10, 2005 that did not result in a complete or final agreement; and

Whereas, JPMorganChase refused to indemnify the Board; and

Whereas, JP MorganChase also insisted that the contract include a provision that the Trust Fund participate in a "Overdrafts" program that authorized JPMorganChase to make interest bearing advances to the Trust Fund to settle trades if there were insufficient funds in the cash account; and

Whereas, JPMorganChase clearly indicated the foregoing issues were final, threshold, and non-negotiable: and

Whereas, numerous other issues (including that JPMorganChase does not have errors and omissions insurance) remained unresolved, and negotiations had become unduly protracted; and, several issues were awaiting approval from other divisions of JPMorganChase; and

Whereas, Treasury staff concluded that further negotiations would be futile and not in the interest of the PACT Trust Fund and has so notified JPMorganChase; and

Whereas, the Bank of New York was considered the next candidate to best meet the needs of the PACT Program, and subsequently Wachovia Bank; now

Therefore, Be It Resolved, that the Board authorizes the Treasurer to negotiate and execute a contract with Bank of New York for Trust Fund Custodial Services and Securities Lending for PACT for a five year period as heretofore authorized by the Board and noted in the Request for Proposals. The Treasurer is further authorized to negotiate with Wachovia Bank should there be a need if contract negotiations are deemed futile with Bank of New York.

THE ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM

MEETING OF THE BOARD OF DIRECTORS

August 24, 2005

MINUTES

Present:
Chairman Kay Ivey
Mr. Russell Buffkin
Mr. Willie Huff
Mr. Ricky Jones
Dr. Mike Malone
Ms. Sarah Moore
Dr. Harold McGee
Mr. Ed Sherling
Mr. Chris Moseley representing Lt. Governor Lucy Baxley
Absent:
Dr. Roy Johnson

Others Present:
Mrs. Daria Story, Assistant Treasurer and Chief Operating Officer
Mr. Anthony Leigh, Deputy Treasurer
Mrs. Brenda Emfinger, College Savings Programs Director
Mr. Roman McLeod, College Savings Programs Coordinator
Mr. Mike Manasco, Treasury Legal Counsel
Mr. Bud Pellecchia, Investment Consultant, Callan Associates
Ms. Sherry Mack, Court Reporter (2nd part of meeting)

Pursuant to written and public notice, a meeting of the Board of Directors of the PACT Program was held in the 3rd Floor Conference Room of the RSA Union Building, Montgomery, Alabama on August 24, 2005.

Agenda Item II.
The meeting was called to order by Chairman Kay Ivey at 8:20 a.m. with a quorum present. Treasurer Ivey presented the minutes of the May 25, 2005 board meeting. A motion was made by Dr. McGee, seconded by Mr. Huff for approval as written. The motion unanimously carried.

Agenda Item III.

Agenda Item III.
Mr. Jones provided a report from the Investment Committee, including the minutes of the previous meeting. Mr. Jones then discussed with the Board the manager search process used by the committee. Mr. Jones asked Mr. Pellecchia to review the proposed domestic fixed income allocation. Mr. Pellecchia explained that based on a recent study prepared by Callan, the committee recommends diversifying the domestic fixed income allocation to be composed of TIPS (Treasury Inflation Protection Securities), a core plus management style, and the current core plus style. Because of this recommendation, only one core fixed income manager would be needed because of the reduction in the amount of assets for this style. Mr Jones stated that the committee recommends retaining Sterne Agee to be the sole fixed income core manager. Mr. Huff questioned if the allocation was to diversify risk or to get a better return. Mr. Pellecchia responded that it was for both. Mr. Huff then expressed his concern about the limited depth of investment managers at Sterne Agee. Recent management and personnel changes at Sterne were also mentioned. It was agreed that the Investment Committee would review the proposals recently received for a core fixed income manager and recommend to the Board a replacement manager that could be contracted if the need arose.

On behalf of the Investment Committee, Mr. Jones recommended to the Board that the following firms be interviewed:
Domestic Large Cap Growth – Peregrine, Intech, Voyageur
Domestic Fixed Income Core Plus – Western, Hartford

Agenda Item IV. A.
Treasurer Ivey asked Ms. Emfinger to explain the review of the proposals received for actuarial services. Ms. Emfinger provided information for the Board concerning the evaluation which included an analysis of the firm, fees, services, and experience. A summary of the calls to references for each firm was also provided. Ms. Emfinger stated that four proposals were received and that one was rejected due to fees and no prepaid program experience. Ms. Emfinger stated that three firms: Actuarial Resources, Milliman and Buck Consultant were invited to make presentations to the Board.

Agenda Item IV. A. (1.)
Actuarial Resources was represented by Mr. Bob Crompton, Mr. John Condo, and Mr. Don Yates. Mr. Crompton began the presentation with an overview of the firm and their experience. He stated that they had extensive experience with prepaid tuition programs and provided timely service at a reasonable fee. He further stated that they were allowing for 20 additional hours of work that would be necessary to get a better understanding of the program at no additional cost if they were selected. In depth discussion was held regarding tuition projections,

pricing contracts and dealing with deficits. Mr. Crompton shared many experiences he has had with other state prepaid programs, and the assistance and consultation that they have provided.

Agenda Item IV. A. (2.)
Buck Consultants was represented by Mr. Dan Sherman who is the current provider. Mr. Sherman distributed a handout that provided information related to the service provided by Buck. Mr. Sherman explained that his strength was the quality of the work and being able to explain actuarial information in layman's terms. He also reiterated his experience in working with PACT and the ability to provide a detailed gain/loss analysis. The company's recent acquisition by Affiliated Computer Services (ACS) was discussed. Mr. Sherman was questioned about hourly fees related to additional work and this was explained as follows: Mr. Sherman @ \$375/hour; Mr. Brau @ \$275/hour and Ms. He and Ms. Bui at \$175/hour.

Agenda Item IV. A. (3.)
Milliman was represented by Mr. Bill Reimert. Mr. Reimert discussed information about his firm. He then called the Board's attention to his presentation concerning the current PACT trust fund deficit. He stated that he was concerned about the 9% rate of return assumption and discussed his thoughts on the future of prepaid programs in general. He discussed his belief that the programs were not viable without full faith and credit or some other backing. When questioned about lost business, he stated that the primary reason was fees or in the case of Illinois, a mutual lack of comfort. He also stated that he was very accessible to his clients.

Following discussion, the Board expressed an opinion that Actuarial Resources would be the best provider for actuarial services.

Agenda Item IV. B.
Treasurer Ivey asked Mr. Pellecchia to discuss the presenters for a large cap growth equity manager. Mr. Pellecchia discussed information provided on the three firms. Informational materials are attached for reference. Treasurer Ivey asked Mr. Pellecchia if any Alabama firms responded. He stated that a proposal was received from AmSouth but did not meet the minimum requirement for assets under management and that their style was more core oriented. He had held discussions with the staff of AmSouth.

Agenda Item IV. B. (1.)
Peregrine was represented by Mr. John Dale and Ms. Stephanie Adams. As the current provider, Mr. Dale discussed the firm and the style of management. He stated that they limited their firm to 25 clients and concentrated on the large cap

growth style, believing that growth is coming back into favor. He discussed their performance and their adherence to fundamentals.

Agenda Item IV. B. (2.)
InTech was represented by Mr. Terry Paquette and Mr. Russell Bjorkman. Mr. Paquette discussed the unique method used to compile their portfolio which is a mathematically based risk controlled process. They further discussed the firm and other information related to their business.

Agenda Item IV. B. (3.)
Voyageur was represented by Mr. Michael Lee, Ms. Shireen Eddleblute and Ms. Bridget Thompkins. Mr. Lee discussed information on the firm. Ms. Eddleblute discussed their process for compiling their portfolio and their style.

Following discussion, the Board expressed an opinion that InTech would be the best provider for domestic large cap growth equity management.

Agenda Item IV. C.
Treasurer Ivey asked Mr. Pellecchia to discuss the presenters for a core plus domestic fixed income manager with the Board. Mr. Pellecchia discussed information provided on two firms. Informational materials are attached for reference. Mr. Pellecchia stated that no proposals were received from Alabama firms.

Agenda Item IV. C. (1.)
Western was represented by Mr. Joseph Carieri and Mr. Donald Plotsky. Mr. Carieri and Mr. Plotsky discussed information on their firm and their style of management. It was noted that the firm did use TIPS in their portfolio. Mr. Carieri informed the Board that they were proposing a change in their fee structure to offer 15 basis points.

Agenda Item IV. C. (2.)
Hartford was represented by Ms. Tracy Eccles and Mr. Scott Crossley. They discussed their firm and their process. They stated that their proposed fee was 30 basis points.

The Board discussed the two proposals and expressed an opinion that Western would be the best provider for domestic fixed income core plus management. The Board then discussed whether or not an additional TIPS manager would be needed since this firm could also provide management for a TIPS portfolio. It was the consensus that this firm could provide both and that there would be less risk having TIPS as part of the core plus portfolio.

At this time, Ms. Sherry Mack joined the meeting to transcribe the minutes.

Treasurer Ivey called on Ms. Emfinger for the program report.

MS. EMFINGER: We are in enrollment and have received about 458 applications. In the past, the majority of applications came the last two weeks of September. People are procrastinators. I'm hoping that's going to be true again this year. We are also in the process of updating the web site that we make available to the colleges. In the past, we sent them hard copies of rosters, which were very large. Now we have given them online access. We update those numbers so that they have clear balances for hours and fee terms for all the students; they're real excited about that. And that way, we can communicate with them in terms of information related to invoicing or changes in the qualified fee structure, that type of information.

We are also in the process of changing custodians to the Bank of New York. They have mailed out letters to the managers and the transition is going well. The custodial change will be a good change for us because when Compass was the custodian, the internationals had to be custodied at the Union Bank of California. So we'll be able to streamline some of our accounting in that process.

DR. MALONE: How did the waiving of the application fee for those who enrolled in June go?

MS. EMFINGER: Well, it went well in the sense that those people that got it were glad to get it. Those that didn't were not. I'm not sure if the delay in getting the brochures out had something to do with the fact that we didn't have any more people to sign up during that time than we did. Do you have any questions for me related to any of the information that we've provided? Thank you.

CHAIRMAN IVEY: Bud, investment report.

MR. PELLECCHIA: I'm sure you have my June 30th investment performance report. I won't go into as much detail as I have in the past. We've had a long day, and we still have a lot to go.

Let me just start by drawing your attention to section 1, page 2. You see a snapshot of the performance of the various asset classes for the quarter and to year ending. You see a mix of black and red numbers. The S&P 500 was in positive territory, up 1.37. Non-US equities were down 1 percent. The dollar was stronger during the quarter. U.S. bond market had a very strong quarter, up over 3 percent.

For the year, some good numbers. S&P 500 up by 6 percent. Non-US equities up over 13, and the domestic bond market actually even outpaced the equity market, up 6.8 percent.

On page 3, in the small box, for the quarter, smaller caps continue to outperform the larger caps. Mid caps actually did the best. S&P 400 up 4.26. Small cap up 3.94, and the large cap up 5.37. We did see a small shift towards growth. Large cap growth was up to 2.90 percent while large cap value was up only 1.66 percent. And we are starting to see a movement towards growth in the small cap area as well. Growth outperformed value. However, for the longer period of one year, at the bottom of the page, small and value have continued to be the place to be.

Page 4, performance of the fixed income markets. Despite the fact that the Fed was raising short-term rates, long-term rates actually came down during the quarter. People thought that we hit a soft patch in the economy. So the Lehman Aggregate was up over 3 percent. Those managers that had extended maturities/ longer duration, actually did the best because of the longer-term rates coming down. High yield had a decent quarter, up 2 percent but not like it was going gang busters in the previous couple of years.

High yield for the full year is up 9.75. As Western was pointing out, depending on where you were on the yield curve, had a lot to do whether you were rewarded or not.

On page 5, international equity, pretty much the same type of story this quarter as it was for the previous quarter: stronger dollar. The local markets were actually up 4 percent, but the dollar was up 5 percent. So that eliminated all the gains that U.S. investors had. And you actually, therefore, lost 1 percent in value. Emerging markets continue to be a strong place to be, and the one year number shows us how it's up over 35 percent in emerging markets.

If you'll flip now to your next section, page 9, this is the target asset allocation. And it's pretty close to target based on the old targets. As you know, as will be talked about later in the investment policy statement, we are adjusting the allocation to international equity. And that's going to come at the expense of large cap equity mainly but, also, somewhat at domestic fixed income. So we are moving to 21 percent international equity from 15, and we're moving from 30 percent fixed income down to 28.

The small cap will stay the same at 9 percent, and the large cap equities will go to -- I believe it's 41 or 42. So as part of that rebalancing, obviously, we have decisions to make on the fixed income side. But we do need to rebalance between domestic equity and international equity. We need to put more into the international markets.

And that would require basically taking money from Peregrine and Bear Sterns because they are the two large cap equity managers on the domestic side. Bear Sterns has more assets than Peregrine just because value had outperformed growth. But I don't know if it's the pleasure of the Board that we make that move, make that decision to move those assets now.

CHAIRMAN IVEY: The statement has been made. Do we need to move funds to international?

MR. HUFF: We need to rebalance from domestic equity into international.

MS. MOORE: I move approval to rebalance the portfolio as stated by the investment committee.

MR. SHERLING: Second.

CHAIRMAN IVEY: You've heard the motion that we rebalance the asset allocations in accordance with the new investment guidelines.

CHAIRMAN IVEY: Any discussion? You've heard the motion with a second. All in favor?
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: Any opposition? The motion carries to rebalance.

MR. HUFF: And here's the other question. Do you take some from Bear Sterns and/or just take it all from Peregrine?

MR. PELLECCHIA: Well, my suggestion is that, if you look at page 15 where we've had the large cap assets, you have an overweight to Bear Sterns, which means you have an overweight to value of $9 million. I would like to see the large cap growth manager, whoever it is, Peregrine or somebody else, have an equal amount of money as the value manager, Bear Sterns.

MR. HUFF: We can make a motion that the two large cap managers have the same dollar amount after the rebalancing, and the difference goes into international.

MS. MOORE: I'll second that.

CHAIRMAN IVEY: You've heard the motion and the second. All in favor say aye?
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed, nay? Motion carries.

MR. PELLECCHIA: Back to the report on page 10. We had a decent quarter for the quarter ending June 30th. At the bottom of the page, you see the actual return was 2.34 percent positive. The target return having been a hundred percent invested in index funds at the target weight would have produced 2.08 percent. Managers added 31 points. The asset allocation was a slight negative of 6 basis points. So we had a good quarter.

If you flip to page 13, the rankings also show that it was a strong quarter; however, we have a lot of ground to make up by looking at page 13. We were at a 16th percentile for the quarter, yet near the bottom for longer periods that go back four and a quarter years.

The next page on page 14 takes it out even further., Since inception, you have achieved your actuarial hurdle rate, 9.83 percent, even though the last four years have not been good.

If you flip now to the section marked domestic equity, I will get into the performance of the individual managers. Peregrine had a strong quarter, up over 4.8 percent, ranking in the top quartile. However, as we talked about before, their last three years have not been that strong. They trailed the benchmark and ranked below median. The since inception number is ahead of the Russell 1000 growth and pretty much right at the median, slightly ahead.

Page 30, performance of Rhumbline. It's doing what it's designed to do which is to track the benchmark. However, active large cap core managers have outperformed the index over this period.

We have talked about in the past about moving the benchmark for Rhumbline from the Russell top 200 to S&P 500, which gives it a little bit more broad exposure. I would make that recommendation that we change the benchmark for Rhumbline from the Russell top 200 to the S&P 500, which gives it a little bit more of a broader exposure.

We have already addressed that they would continue as our index manager, but I think that we can get broader exposure with the 500 rather than with the Russell top 200.

CHAIRMAN IVEY: Is there a motion to that effect?

DR. McGEE: So move.

MR. SHERLING: Second.

CHAIRMAN IVEY: Any discussion. All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed nay? Motion carries.

MR. HUFF: Bud, in the investment policy, how much money is the index manager supposed to have?

MR. PELLECCHIA: The policy does not state how much should be managed in index funds.

MR. HUFF: Well, I guess my question is, how did we decide that Rhumbline would have 21 percent of the portfolio or whatever that is?

MR. PELLECCHIA: Well, that was approximately the amount that we had in there before I got involved, and I concurred that about 20 percent makes sense for a plan your size to have that type of exposure to the index fund. And it makes the most sense to have index management in the most efficient asset class, large cap stocks, as opposed to international fixed income.

MR. HUFF: I'll just make a point that if we have 135 million of our 655 million in an index fund that has underperformed for five years on average then, obviously, our whole portfolio, is not going to look too well for the simple fact that it's mimicking the market.

MR. PELLECCHIA: That's correct. You are mimicking the market with that exposure.

MR. JONES: How many dollars does Rhumbline have, and how many does Peregrine have?

MR. HUFF: Rhumbline has 135,421,000. Peregrine has 80,506,000, and Bear Sterns has 89,580,000. Here's my point. If we have an investment return assumption of 9 percent and our large cap equity, which is indexed, and the index is under water for five years, it's almost impossible math to make that up.

MR. PELLECCHIA: Well, there are times when the index is a tough bogey to beat, and index funds actually outperform active managers. Over the last five years, that hasn't been the case, especially with the top 200 as Rhumbline has been invested in. Going forward, if the market takes off, the index fund is going to do well.

MR. JONES: Would we be overaggressive to restructure those to be a third, third, and third of the total – basically a hundred million each?

MR. PELLECCHIA: I don't think that's out of line at all. Again, this is a philosophical question. Do you believe in active management versus passive management? Passive management gives you low turnover. It gives you low fees and gives you the market. You don't have to worry about manager risk.

MR. JONES: Well, if we're going to have an assumption of 9 percent and that number is shrinking every year because we're not even coming close to it, we've either got to change our assumption, change our philosophy there, or we've got to be more aggressive to reach the 9 percent. And it seems like by putting a third, third, and a third, we're showing to be a little more aggressive. We've got to either change the assumption, or we've got to be more aggressive on making that assumption.

DR. MALONE: The first question has to be answered before you reallocate in proportion is, Do we want to be more aggressive, whether with an active participation versus the passive? And once we answer that question, then partitioning and reassigning of the percentages makes more sense.

MS. MOORE: Well, I think we discussed this at a previous meeting – that we're not happy with being in the bottom percentiles. If you look at Rhumbline, even though they are tracking the index, the index is at the bottom. Index funds are at the bottom of that group, if this chart is correct. And we all decided that is not acceptable because we're not bottom-25-percentile kind of folks.

DR. McGEE: Question. Did long-range planning committee come up with any recommended change in assumption?

MR. SHERLING: No, there was nothing definitely done about that.

MR. PELLECCHIA: In the past, the assumption was directed by the actuary, if I'm not mistaken. And we took their number for granted with some discussion. But I think from the discussion we heard today from the other actuaries, it may be too high of a number. Our asset allocation told you that you probably can't get there over the next five years unless you went extremely aggressive. But there are other ramifications of lowering your discount rate, lowering your actuarial return. It means that you're going to become less funded.

MS. MOORE: Well, you can't just look at just one of those assumptions. It's the spread between the tuition increases and investment return. You've got to look at both sides.

DR. MALONE: My only observation again as an almost third party objective on this is that I don't think it has to be either or. I think it's a combination of things that need to be looked it. And I'm hearing the conversation to be, okay, we either change the assumption or we get more aggressive. I keep hearing us talk about being more aggressive. And Bud asked us a question 20 minutes ago, you know, about some direction, about do we err on the side of positivity, do we err on the side of a little bit more aggression? Or do both. And I think that's a strategic question that the investment committee ought to take up.

CHAIRMAN IVEY: Where are we?

MR. PELLECCHIA: I'm continuing with the report, if you'll flip to page 33. This is the performance of Bear Sterns. They've been your large cap value manager for a year now. And they have continued to underperform. This past quarter was pretty close to the benchmark and just below median. They were hurt by individual stocks.

Since inception, they are significantly behind the Russell 1000 value. Nothing has changed at the firm. Their longer term performance is very good. Unfortunately, since you've been invested with them, they've underperformed. It's just one of those things. They still are being considered for new searches when we do search work, but this fourth quarter period has been an underperforming period. We're obviously keeping a close eye on them, but we think it's too short of a period to make an action. If you'll flip to page 36, Earnest Partners has had another strong quarter. They're your small cap value manager. You've been invested with them for a year as well.

Turner Investment Partners is your new small cap growth manager. They beat the benchmark, the Russell 2000 growth. However, they were just slightly below median for this first quarter, 57 percentile.

International equity, the new manager is New Star Institutional. They beat the benchmark. They were basically flat for the quarter. However, the benchmark was down. And that put them in the 35th percentile. And finally, the last section, fixed income. AmSouth did have a good relative quarter. They were ahead of the benchmark by a basis point, ranked in the 26th percentile. The two and three year numbers are not that strong - below the benchmark for the two year and right at the benchmark number for three years. Their longer term performance though has been good.

And finally, on page 51, Sterne Agee which has had a pretty much same level as AmSouth for the quarter at 28 percentile at the benchmark, ahead of the benchmark for the year, but below median and over longer periods, very strong performance.

And then getting back to your question, Willie, Sterne Agee, although having great performance over the last five years, they trail Western core plus portfolio for that five year period. This concludes the report.

CHAIRMAN IVEY: Bud, thank you very much. Next business is Item V.A(3), page 72 in your agenda, trading cost analysis. Brenda, is there anything that needs to be said about that?

MS. EMFINGER: As you will recall, last meeting, we had a representative from Abel/Noser who came and explained this report to you. We have narrowed it down to this one page, and until it tells us something that you need to be aware of in terms of a manager's cost exceeding what it should, it's just for information.

CHAIRMAN IVEY: New Star amendment, Mike Manasco, page 73 and 74.

MR. MANASCO: Yes. This is an amendment to the contract where New Star is going to outsource to HSBC Institutional Fund Services trade distribution, trade matching, and foreign exchange settlement instruction. This was looked at as a good thing for them to be doing as this organization is taking the lead in trying to facilitate international settlement. And they have agreed the purpose of the amendment was to formalize it, that they will remain primarily liable to the Board for the performance of any outsourced obligations. So it didn't change anything to do with the contract other than to give them permission to do this, and they remain primarily responsible for all indemnifications and standards of care in the original contract.

CHAIRMAN IVEY: No action is required. It's just a matter of information. Report of the PACT marketing for '05, Anthony Leigh.

MR. LEIGH: We have put into place the marketing plan that we shared with you at the last two Board meetings. The TV commercials ran heavy in May and June. We've tapered them off a little bit in July and August, and they'll pick up again heavy in September for the last month of marketing.

Our radio ads will run on the Alabama and Auburn radio network during the month of September. While our TV commercials have tapered off in July and August, the Treasurer and I have used that opportunity to get out and travel the state, promoting the program. So far this month, we have attended 34 counties. We will be in seven more on Monday. By the end of the month, we will have been in 55 counties in the last two months, talking to editorial boards, newspaper reporters, doing morning TV shows, talk radio. We've had a number of press conferences on college campuses not only highlighting the PACT enrollment is open now, but also the number of students that are currently attending that school, using the PACT program to show that this has been in existence for 15 years.

Another marketing item that I want to mention to you is an initiative that the Treasurer and I have met with President of Alabama State about, Dr. Joe Lee. Obviously, this Board has a passion for encouraging people to save for future college expenses. Colleges also have a vested interested in making sure the families are saving because they need to have resources to be able to send children to those colleges. Colleges are also in the business of marketing themselves to make it attractive for families to send their children to that school.

So we have met with Dr. Lee, and we'll meet with other presidents as well to ask if they will provide some incentives for families to save by PACT or by 529 and if the child meets certain scholarship requirements such as a 24 on the ACT and 3.0 GPA and chooses to attend this school, the school will give them a $500 book scholarship or some other financial incentive of their choice.

It's not going to be anything that would cost the program or be a requirement on the part of the Board, but would be something the colleges could use as an incentive to encourage people to save and, once they've saved, attend that college. Dr. Lee was very receptive to the idea and will meet with his advisory counsel and get back to us. But hopefully, that's something that we can promote in the next couple weeks and months.

CHAIRMAN IVEY: Thank you very much. Attached are recent articles as informational. Before we go to decision items, several other issues have come before us. What if we focused on having staff gather information and having a working session of the Board to review the large cap equity asset allocations, including the index percentage; and secondly, review investment return and other assumptions for the annual actuarial review?

MS. MOORE: I think Bud needs to have input, as well as the actuary. On the plans I work with, with actuaries, they look to management to make all assumptions to go in the report because they're an independent advisor. And so they have independent standards just like public accountants.

DR. MALONE: I think our recent history will show that the two items that you mentioned are items that seem to reoccur every time we meet. And so that probably is the message that we need to have a work-through session where we finally come up with some recommendations.

DR. McGEE: Kay, do you we know where 9% came from and the logic?

MS. EMFINGER: Oh, absolutely.

CHAIRMAN IVEY: All right. With your permission and guidance then, we will definitely do that and try our best to schedule a work session at the earliest possible time and in advance of November 30. Is this acceptable?

MS. MOORE: Yes.

CHAIRMAN IVEY: Now, decision items, Item VI on the agenda, qualified fees, pages 82 through 84. Brenda, do you need to speak to this?

MS. EMFINGER: Well, basically, the Board reviews the mandatory fees, which we are now calling qualified fees, and provides approval of those fees. So what we did was to provide a spreadsheet for you that gives you the fees at all the public colleges and universities. And the only one that we call your attention to is a new fee, a fee that the Board did not approve last year but has appeared this year. And the one new one is with the junior community colleges, and it's called a building fee.

The basic definition is that a mandatory or qualified fee is one that is required as a condition of enrollment for every student that attends that particular university.

CHAIRMAN IVEY: But every student who goes to a junior or community college is required to pay this new building fee?

MS. EMFINGER: Not every junior and community college charges it, but every child that goes to that particular one where they do have it has to pay it.

CHAIRMAN IVEY: So you're asking -- the recommendation is to adopt the fees presented?

MS. MOORE: I move it.

DR. McGEE: Second.

CHAIRMAN IVEY: Any discussion?

MR. JONES: We have a member of this Board that represents the junior college/community college segment of higher education. It's a shame that we have to make this decision without input from the side of higher education that's represented on this Board but chooses not to attend these meetings.

MS. MOORE: It's in our charter, is it not, to pay mandatory fees?

MS. STORY: It's not actually in the law. It is in the law that we will pay mandatory fees, but then the fees are defined by the Board.

MS. MOORE: I misunderstood. When I made the motion, I assumed that we had to -- basically, it was in our charter.

MS. EMFINGER: We do not pay any course-specific fees. We don't pay student activity fees, application fees, orientation fees. Every child that goes there has to pay them, but they are excluded.

MS. MOORE: Well, I withdraw my motion.

CHAIRMAN IVEY: Motion withdrawn.

DR. McGEE: Second.

CHAIRMAN IVEY: So the question before us, we have a recommendation to approve qualified fees. If we deny that or postpone the decision thereof pending information, any fee not approved will not be paid.

DR. MALONE: I move that we postpone making a decision on the new building fee for the two year systems indefinitely until additional information is received, and to approve the other fees.

MR. SHERLING: Second.

CHAIRMAN IVEY: Mr. Sherling has seconded. Discussion.

DR. MALONE: This is a new fee. So if the motion passes, then we're obliged to alert Dr. Johnson's office that this is a pending issue. And that doesn't mean that it can't be added on at another time. My motion was indefinitely.

MS. STORY: Brenda, can you clarify on this spreadsheet that what we're talking about is the building fee column?

MS. EMFINGER: Right.

MS. STORY: We're showing that Alabama A&M, UAB, and South Alabama all have a building fee that we have been paying in the past?

MS. EMFINGER: That's right.

MS. STORY: So the motion on the table is to withhold paying the building fee for the junior colleges, even though we have been paying a similar titled fee for the four year colleges.

DR. MALONE: I want to hear some more discussion about that.

MR. HUFF: We're paying a building fee for some of the four year colleges.

MR. JONES: Is that because that's the only ones that have them?

MS. EMFINGER: Right.

MR. SHERLING: Our concern is, if they keep adding and adding and adding, at some time, we're going to run out of money.

MR. JONES: And when you get down to it, all they're adding is revenue to the bottom line to pay for the expense. Whether they say it's a building fee or whatever, it's the cost of tuition. It doesn't matter if they break it down into building fees or whatever.

DR. McGEE: That's a pretty healthy fee per student.

DR. MALONE: Another reason that it might be opportune to not table this but postpone this is because I think there is enough ambiguity about what we're being asked to do that we need to gather additional information to be able to make a better decision on it.

CHAIRMAN IVEY: The motion before us is to postpone indefinitely the payment of the building fee for junior colleges; and to approve the other proposed fees. There has been a second. Any more discussion? What's the pleasure of the Board? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed, say no.

MR. HUFF: No.

CHAIRMAN IVEY: All right. Motion carried. We will indefinitely postpone, and we will gather additional information and certainly encourage Dr. Johnson to join us at the next meeting.

MR. JONES: Well, Madam Chairman, I'm concerned about Dr. Johnson's lack of attendance to these meetings. I am disappointed in his lack of participation and the building fee is just an example where his being involved would help make this process easier and better for us. For the ones of us in the business world, especially for three of us or four of us that work for ourselves, we travel many miles to get here, many miles to get home. We make special effort to be here.

DR. MALONE: I would say your point is very well taken. There's no opposition to the spirit of it. I'd be happy to go talk with Chancellor Johnson, and if anybody else would like to be a part of that.

CHAIRMAN IVEY: VI.B., consideration of resolution for allocation of fixed income, page 85.

MR. JONES: Bud, question. Based on the thought we had with our core plus investing in TIPS, do we actually need at this time to pass this resolution?

MR. PELLECCHIA: No. This resolution allows for a separate allocation of TIPS. We just saw that one of the managers we interviewed has a significant allocation for TIPS. If you went with that manager and overweighted them, I think you can do away with this resolution.

CHAIRMAN IVEY: That's a great statement. Is there a response from the Board?

MS. MOORE: I move the item be pulled.

CHAIRMAN IVEY: So moved. The item is pulled. Item VI.C., resolution to amend the investment policy. Investment committee went through this thoroughly. This is their recommendation. Is there a motion?

MS. MOORE: I'll move it.

MR. SHERLING: Second.

CHAIRMAN IVEY: Second by Mr. Sherling. All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed say nay. The motion carries.

CHAIRMAN IVEY: Page 107, Item VI.D., this is resolution regarding domestic fixed income core plus manager.

MS. MOORE: I move that we appoint Western.

MR. HUFF: Second.

CHAIRMAN IVEY: Motion made and seconded. Any discussion? As part of the resolution, we need to clarify who the next preferred respondent would be.

MS. MOORE: I'll move that be Hartford

MR. SHERLING: Second.

CHAIRMAN IVEY: Ms. Moore moves it; Mr. Sherling seconds. All in favor say aye. (Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed say nay.

Next order of business is Page 108, large cap growth equity manager. And what is your pleasure to execute a contract with?

MS. MOORE: Intech and then Voyageur?

DR. MALONE: I move.

MR. SHERLING: I'll second that motion.

CHAIRMAN IVEY: Mr. Sherling seconds. Is there any discussion? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed, nay. Motion carries. Now, on page 109, we're going to look for a domestic fixed income core manager.

MR. HUFF: I move that be Sterne Agee.

MR. JONES: Second.

CHAIRMAN IVEY: Any discussion? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: All opposed, nay. Motion carries.

Item VII.G., page 111, consideration of resolution for domestic indexed equity manager.

MR. JONES: It was the recommendation from the investment committee to continue with Rhumbline, and I move that.

MR. HUFF: Second.

CHAIRMAN IVEY: Any discussion? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: Motion carries. Domestic equity index manager to continue to be Rhumbline.

Agenda Item VI.H., trust fund actuarial consultant to negotiate and execute a contract with?

MR. HUFF: Move it be Actuarial Resources.

DR. McGEE: Second.

MS. EMFINGER: Second choice to fill in the second blank.

MR. JONES: I would hope that there's no question that Actuarial Resources will take the contract.

DR. MALONE: I agree that we not include a second choice at this time.

CHAIRMAN IVEY: Make the motion to say that the first choice will be Actuarial Resources and we'll just delete the last paragraph of that resolution. Is there a second to the motion?

MR. SHERLING: Second.

CHAIRMAN IVEY: Any discussion? All in favor say aye.
(Board members in favor of the motion so indicated.)

CHAIRMAN IVEY: Actuarial Resources is our choice.

CHAIRMAN IVEY: Our next meeting is November 30, but we have an interim meeting, a workshop type situation to evaluate the information we've described.

DR. MALONE: I move adjournment.

CHAIRMAN IVEY: You've heard the motion for adjournment of the PACT Board of Directors, and we stand adjourned.

(The meeting adjourned at 3:29 p.m.)

Kay Ivey

Chairman, Kay Ivey

AGENDA ITEM VI. (A.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Approval of 2005-2006 Qualified Fees

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, The PACT Program is established whereby purchasers enter into PACT contracts for the future payment of tuition and mandatory fees at eligible educational institutions as provided in Section 16-33C-6 (a) *Code of Alabama, 1975;* and,

WHEREAS, the Board has defined mandatory fees as Qualified Fees required as a condition of enrollment for all students attending the Postsecondary Institution in which the Designated Beneficiary is enrolled; now,

Therefore Be It Resolved, that the revised schedule of Qualified Fees, with the exception of the "Special Building Fee" at the 2 year colleges, in substantially the form presented to the Board and attached hereto, shall be, and hereby is, approved and adopted by the Board on behalf of the PACT Program for the 2005-2006 academic year.

AGENDA ITEM VI. (C.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Adoption of Changes to the Investment Policy

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the Board has the power to invest as it deems appropriate any funds in the PACT Trust Fund in any instrument, obligation, security, or property that constitutes legal investments for public funds in the state, including legal investments for the State Treasurer and the Alabama Trust Fund; and,

WHEREAS, the Board has the power to establish other policies, procedures, and criteria necessary to implement and administer the provisions of the law; and,

WHEREAS, the Board's Investment Consultant, Callan Associates, has reviewed and revised the 2004 Investment Policy to indicate recommended changes to the Board; and,

WHEREAS, the Board has considered the recommended changes and an Investment Manager Acknowledgment for receipt of Investment Guidelines drafted by general counsel to the Treasurer;

NOW, THEREFORE, BE IT RESOLVED, that the revised Investment Policy and Guidelines Statement dated August 2005, in substantially the form presented to the Board be, and hereby is, approved and adopted on behalf of the PACT Program;

AGENDA ITEM VI. (D.)

Adopted Resolution by the PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Selection of PACT Domestic Fixed Income Core Plus Manager

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), *Code of Alabama, 1975* and,

WHEREAS, the State Treasurer widely disseminated the Request For Proposals through the Treasury website and in compliance with Section 41-16-72 of the Code of Alabama and;

WHEREAS, the Board of Trustees ("Board") thereafter received 19 written responses to the previously authorized Requests for Proposals for Domestic Fixed Income Core Plus Investment Management Services; and

WHEREAS, the PACT investment consultant, Callan Associates, has evaluated all of the Proposals and the Investment Committee recommended two (2) respondents to make oral presentations to the Board on August 24; 2005;

WHEREAS, Section 16-33C-5(7) authorizes the Board to contract for services of qualified persons and entities and provides that all such contracts awarded by the Board may be for periods not exceeding five years;

NOW, THEREFORE, BE IT RESOLVED, that based on the oral presentations made to the Board from the firms recommended by the Investment Committee the Board authorizes the Treasurer to negotiate and execute a contract with Western Asset Management for Domestic Fixed Income Core Plus Investment Management Services for PACT; and

BE IT FURTHER RESOLVED that said contract be for a five year period including a provision that the services may be terminated with a 30-day notice; and

BE IT FURTHER RESOLVED that if an Investment Management Agreement cannot be successfully negotiated, that Treasury Staff is authorized to negotiate with the next preferred respondent(s) recognized as Hartford.

AGENDA ITEM VI. (E.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Selection of PACT Domestic Large Cap Growth Equity Manager

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), *Code of Alabama, 1975* and,

WHEREAS, the State Treasurer widely disseminated the Request For Proposals through the Treasury website and in compliance with Section 41-16-72 of the Code of Alabama; and,

WHEREAS, the Board of Trustees ("Board") received 37 written responses to the previously authorized Requests for Proposals for Domestic Large Cap Growth Equity Investment Management Services; and

WHEREAS, the PACT investment consultant, Callan Associates, has evaluated all of the Proposals and the Investment Committee recommended three (3) respondents to make oral presentations to the Board on August 24; 2005; and

WHEREAS, Section 16-33C-5(7) authorizes the Board to contract for services of qualified persons and entities and provides that all such contracts awarded by the Board may be for periods not exceeding five years;

NOW, THEREFORE, BE IT RESOLVED, that based on the oral presentations made to the Board from the firms recommended by the Investment Committee the Board authorizes the Treasurer to negotiate and execute a contract with InTech for Domestic Large Cap Growth Equity Investment Management Services for PACT; and

BE IT FURTHER RESOLVED that said contract be for a five year period including a provision that the services may be terminated with a 30-day notice; and

BE IT FURTHER RESOLVED that if an Investment Management Agreement cannot be successfully negotiated, that Treasury Staff is authorized to negotiate with the next preferred respondent(s) recognized as Voyager.

AGENDA ITEM VI. (F.)

Adopted Resolution by the PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Selection of PACT Domestic Fixed Income Core Manager

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), *Code of Alabama, 1975* and,

WHEREAS, the State Treasurer widely disseminated the Request For Proposals through the Treasury website and in compliance with Section 41-16-72 of the Code of Alabama and did thereafter receive

WHEREAS, the Board of Trustees ("Board") thereafter received forty (40) written responses to the previously authorized Requests for Proposals for Domestic Fixed Income Core Investment Management Services; and

WHEREAS, the PACT Consultant has evaluated all of the Proposals and the Investment Committee did not recommend any respondents to make oral presentations to the Board in consideration of the excellent past performance of the current manager, Sterne Agee Asset Management Company; and,

WHEREAS, Section 16-33C-5(7) authorizes the Board to contract for services of qualified persons and entities and provides that all such contracts awarded by the Board may be for periods not exceeding five years;

NOW, THEREFORE, BE IT RESOLVED, that based on the recommendation of the Investment Committee, the Board authorizes the Treasurer to negotiate and execute a contract with Sterne Agee Asset Management Company for Domestic Fixed Income Core Investment Management Services for PACT; and

BE IT FURTHER RESOLVED that said contract be for a five year period including a provision that the services may be terminated with a 30-day notice; and

BE IT FURTHER RESOLVED that if an Investment Management Agreement cannot be successfully negotiated, the matter shall be returned to the Investment Committee for further action and recommendation.

AGENDA ITEM VI. (G.)

Adopted Resolution by the PACT Board of Trustees at its meeting on August, 24, 2005

Topic: Selection of PACT Domestic Equity Indexed Manager

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), *Code of Alabama, 1975* and,

WHEREAS, the State Treasurer widely disseminated the Request For Proposals through the Treasury website and in compliance with Section 41-16-72 of the Code of Alabama; and,

WHEREAS, the Board of Trustees ("Board") thereafter received three (3) written responses to the previously authorized Requests for Proposals for Domestic Equity Indexed Investment Management Services; and

WHEREAS, the PACT Consultant has evaluated all of the Proposals and the Investment Committee did not recommend any respondents to make oral presentations to the Board in consideration of the past performance of the current manager, Rhumbline Advisers; and,

WHEREAS, Section 16-33C-5(7) authorizes the Board to contract for services of qualified persons and entities and provides that all such contracts awarded by the Board may be for periods not exceeding five years;

NOW, THEREFORE, BE IT RESOLVED, that based on the recommendation of the Investment Committee the Board authorizes the Treasurer to negotiate and execute a contract with Rhumbline Advisers for Domestic Equity Indexed Investment Management Services for PACT; and,

BE IT FURTHER RESOLVED that said contract be for a five year period including a provision that the services may be terminated with a 30-day notice; and

BE IT FURTHER RESOLVED, that if an Investment Management Agreement cannot be successfully negotiated, the matter shall be returned to the Investment Committee for further action and recommendation.

AGENDA ITEM VI. (H.)

**Adopted Resolution by the
PACT Board of Trustees at its meeting on August, 24, 2005**

Topic: Selection of PACT Trust Fund Actuarial Consultant

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), *Code of Alabama, 1975* and,

WHEREAS, the State Treasurer widely disseminated the Request For Proposals through the Treasury website and in compliance with Section 41-16-72 of the Code of Alabama; and

WHEREAS, the Board of Trustees ("Board") thereafter received four written responses to the previously authorized Requests for Proposals for Trust Fund Actuarial Consulting Services; and

WHEREAS, the Treasury Staff has evaluated the Proposals and requested three respondents to make oral presentations to the Board on August 24; 2005; and

WHEREAS, Section 16-33C-5(7) authorizes the Board to contract for services of qualified persons and entities and provides that all such contracts awarded by the Board may be for periods not exceeding five years;

NOW, THEREFORE, BE IT RESOLVED, that based on the oral presentations made to the Board from the firms recommended by Treasury Staff the Board authorizes the Treasurer to negotiate and execute a contract with Actuarial Resources for Trust Fund Actuarial Consulting Services for PACT; and

BE IT FURTHER RESOLVED that said contract be for a five year period including a provision that the services may be terminated with a 30-day notice; and

THE ALABAMA PREPAID AFFORDABLE
COLLEGE TUITION PROGRAM
MINUTES
NOVEMBER 30, 2005

PACT BOARD MEMBERS:

Ms. Kay Ivey, Chairman
Lt. Gov. Lucy Baxley (not present)
Mr. Ed Sherling
Mr. Willie Huff (not present)
Dr. Harold McGee
Ms. Sarah Moore (not present)
Dr. Mike Malone
Dr. Roy Johnson
Mr. Ricky Jones
Mr. Russell Buffkin

ALSO PRESENT:

Ms. Daria Story, Assistant Treasurer
Mr. Anthony Leigh, Deputy Treasurer
Mr. Roman McLeod, College Savings Program Coordinator
Ms. Brenda Emfinger, College Savings Program Director
Mr. Mike Manasco, Treasury Legal Counsel
Mr. Robert B. Crompton, Actuarial Resources Corporation
Ms. Sherry Mack, Court Reporter
Mr. Bud Pellecchia, Callan Associates

* * * * * * * * * * *

Pursuant to written and public notice, a public meeting of the PACT PROGRAM was held in Room 300, RSA Union Building, 100 North Union Street, Montgomery, Alabama, on Wednesday, November 30, 2005, at 10:00 a.m.

* * * * * * * * * * *

THE CHAIRMAN: We'll call the meeting for the Board of Directors for the PACT Program to order, and we'll ask the secretary, Ms. Emfinger, to call the roll.

(A roll call was conducted.)

MS. EMFINGER: A quorum is present.

THE CHAIRMAN: Thank you. We have a resolution honoring Willie Huff, whose term expires December the 8th. And it's our custom to award a resolution to members who have been diligent in their service, and Willie Huff is certainly one of those. Please provide any comments or changes to the resolution, or move for adoption.

DR. MCGEE: Move adoption.

DR. MALONE: Second.

THE CHAIRMAN: All in favor say aye.

(Board members in favor of the motion so indicated.)

THE CHAIRMAN: We notified the Governor's Office as the appointing authority in September that the term was expiring, and I don't have any information about who they will appoint. Next item is approval of the minutes of the August 24th meeting as circulated. Your pleasure? Motion to approve?

MR. SHERLING: So move.

MR. JONES: Second.

THE CHAIRMAN: All in favor say aye.

(Board members in favor of the motion so indicated.)

THE CHAIRMAN: All opposed say nay.

(No response)

THE CHAIRMAN: Motion carried. Minutes are approved. Quarterly reports. Let's start with Ms. Emfinger, page 20 and 21.

MS. EMFINGER: To date, we have received 1,150 applications for 2005. We are currently working with Jackson Thornton on the 2005 financial audit, and the yearly actuarial valuation being prepared by Bob Crompton. I have a printout of all the colleges that we've paid during the calendar year of 2005 and it is almost 500 in number. We have paid out over $40 million including over $12 million to Auburn and over $9 million to Alabama. So if anyone is interested, I will provide a copy of this listing.

(Dr. Johnson and Dr. Malone indicated interest)

MS. EMFINGER: I've also provided some financial information, administrative information. If you have any questions, I'll be happy to answer them.

DR. McGEE: You continue to have sufficient fees to cover you administrative costs?

MS. EMFINGER: Basically, the fees are sufficient; however, if they are not, we supplement with Trust Fund earnings. Payments to the investment managers and the custodian are paid from Trust Fund earnings.

THE CHAIRMAN: All right. Welcome, Bud Pellecchia. We look forward to your report as well.

MR. PELLECCHIA: This is the Callan report dated September 30th. I will walk you through what occurred during the quarter ending September 30th and give you an idea of how the markets performed and then get into individual fund performance and individual managers.

On page 2, you see some mixed numbers. Despite rising interest rates, two major hurricanes, and rising commodity prices, the markets were relatively strong during the quarter. The S&P 500 domestic stocks were up over 3 percent, 3.60. Non-U.S. stocks had a very strong quarter, up over 10 percent. The negative area is the domestic fixed income, which was down 67 basis points, mainly as a result of rising interest rates, resulting from concern over rising inflation.

On page 3, just looking at domestic equity, the U.S. economy continued to send mixed messages. There were rising interest rates and consumer confidence fell pretty sharply during the quarter. However, the U.S. Stock Market had its best quarterly return of this calendar year. As I mentioned, the S&P was up 3.6%. Mid cap and smaller cap stocks, as reflected in this little box in the middle, were better performers than large cap stocks. The S&P 400 was up 4.88%. The S&P 600 was up over 5 percent.

On a growth-versus-value basis, growth for the second quarter in a row outperformed value modestly, both in large cap and small cap. Not surprisingly, investors who held energy, natural resources, and utility stocks did well. In terms of sectors, eight of the ten sectors posted positive returns; with energy, utility, and technology leading the way. And the two areas, telecom and the consumer discretionary, were the two that were underperformers.

For the full year, at the bottom of the page, ending September 30th, we had bookend performance; the fourth quarter of '04 and the third quarter of '05 were the best performers. And that led to some pretty strong numbers for the four quarters ended September 30th. You see numbers there in mid double digits, well above 20 percent in the small cap areas. Small cap value was the best performing over those four quarters.

On page 4 is a look at the domestic fixed income. As I mentioned before, the Lehman Aggregate Index did fall 67 basis points due to rising interest rates as a result of inflation concerns. The Fed did increase the short-term rates by 25 basis points two times during the quarter, finishing the quarter at 3.75 percent. They have since raised it another 25 basis points. So now the Fed rate is at 4 percent. That represents exactly 300 basis point total over the last 18 months. The bond market followed the Fed's lead, and long-term rates increased almost uniformly across the yield curve. So you see there, performance was all pretty much negative except for the very shortest maturities, defensive area and cash. And also, the high yield market, which is not as sensitive to the interest rate moves, had a positive quarter, up over 1.3 percent.

Combination of low supply and strong fundamentals helped the corporate sector. Corporate bonds of equal duration to treasuries outperformed by about 26 basis points. So you'll see later that our fixed income managers who had an overweight to credit outperformed. Lower-rated BBB bonds also helped performance over the quarter. For the full year Lehman Aggregate Index was up a relatively small 2.08 percent, but that was in the face of rising interest rates. So the active managers, the median manager in the core bond space was ahead of that, coming in at 3.22 percent. So active managers did pay off. Those that had extended maturities actually did better just because there were moments when rates were rising and rates were falling. And those managers that took advantage of when rates were falling outperformed. The high yield market continued to do very well, up over six and a half percent for the full year ending September 30th.

On page 5, the international equity markets, as measured by EAFE, was up over 10.3 percent. Similar story, commodity and energy prices boosted a lot of the non-U.S. stocks. It was also propelled by Japan. Japan had one of its best performing quarters, up over 20 percent for the third quarter.

Small cap continued to outperform large cap, and also emerging markets continued to outperform developed markets. You see in the red box there, emerging markets had another stronger quarter, up over 18 percent, and for the full year is very strong, up 47 percent for emerging markets. The dollar continued to climb versus foreign currencies, so that was a wind in the face of U.S. investors. So folks like you actually were hurt by a rising dollar, but it was modest at about 1.1 percent. So you would have had a better return in non-U.S. stocks if it weren't for the rising dollar.

If you skip now to page 9, which is the next section to look at a snapshot of asset allocation, I just want to remind everyone that target asset allocation that's reflected here is the old target asset allocation. We are in the midst of rebalancing the portfolio to the new targets, which will be 42 percent large cap equity; 9 percent small cap, staying the same; and increase in international equity to 21 percent and a decrease in domestic fixed income to 28 percent. So the next report will reflect the new target asset allocation, and the actual should be pretty close to that as we rebalance. As of the end of the quarter, you did have a slight overweight to domestic equity, 1 percent overweight to large and 1 percent overweight to small cap. And that was at the expense of fixed income.

If you turn to the next page, page 10, this is a breakdown of the performance for the quarter. The actual return at the bottom of the page was 3.13 percent. The target return, being that had you been 100 percent invested in index funds at the target weight, would have produced a higher return of 3.59 percent. The active managers detracted value of 50 basis points for the quarter. And you can see that mainly came from large cap equity -- really, one manager, Bear Stearns -- and international equity detracting 28 basis points. The asset allocation effect is the deviation from your target weight in the asset classes. That was a slight positive of five basis points.

If you'll flip to page 13, you can see how your fund has ranked against other public funds in our database at Callan. The numbers aren't that great; however, on an absolute basis, they are stronger over the last three years. You have achieved over 12 and a half percent annualized return; however, that has ranked below the median, in the 74th percentile for that time. And we know that it has been the specific managers that have underperformed, some of them new managers, but also some of the managers that we've already terminated.

The four and a half year number is also a poor number. Now, that is a reflection of two things. One, it is managers that have underperformed, but also that included the bear market where you had an overweight to equity versus a lot of your peers in this group. So that attributed to some of the underperformance, but your managers also had underperformance as well.

Go on to the next page. It's the same analysis; but I want to point you to the long-term number, that 14 and three-quarter years from the inception of the PACT Fund, you have achieved your actuarial hurdle rate of 9 percent. You're at 9.89% for that full time period since inception; however, you do trail the target benchmark.

On page 15 is the assets. I just wanted to point out that now we have a three-plus percent return on 655 million. That is a significant increase in assets. Investment return gained over \$20.5 million for just the one quarter, so a very strong quarter on an absolute basis.

Page 25, getting into the individual managers. Peregrine is the large cap growth manager who is being terminated; and they actually did have a good quarter on their way out the door, up over 5 percent in the 38th percentile against other large cap growth managers. And you'll see that they've underperformed over the last two years; however, their longer term numbers are slightly above median and ahead of the benchmark.

Flipping ahead to page 30 is performance of Rhumbline, which is your large cap index manager. They have performed as you would expect large cap index fund to perform in that they are trying to track this benchmark, which is the Russell Top 200. And they have tracked it very well, some periods slightly behind, some periods slightly ahead.

Overall, the full six and a quarter year period has been ahead of benchmark but still in negative territory. This benchmark is the largest 200 stocks in the U.S. universe. And against active managers in our large cap core style group, Rhumbline has significantly underperformed; but Rhumbline is doing what we asked them to do, and that's to mimic the benchmark. They are moving to the S&P 500, which is a broader benchmark that includes some smaller stocks, but still the top 500 as opposed to the top 200.

On page 33 is the performance of Bear Stearns. We went over this at the last meeting. But for the full board, they did underperform once again. They were in positive territory at 1.05% but lagged the benchmark. It's going to sound very similar to the Van Kampen story. They've had a continuous underweight to energy over pretty much the last year and also to utilities, which has been the real driver of their underperformance. However, they're going to be here today to talk about what their strategy is.

As I mentioned before, I had met with them about a month or so ago. And they are very convinced that their portfolio is positioned to do very well in the future. I know that they've had a very good last two months. They're ahead of the benchmark by almost 300 basis points.

We said at the last meeting that if they did not beat their benchmark by 500 basis points by March 30th, that we would terminate them; but in the meantime, we'll start the search process. They are aware of that, just so you'll know when they present today. So I think, the last two months shows some improvement; but they know they have more to make up. The full period since inception, they're up slightly less than 8 percent but the benchmark was up over 14 and a half percent. Every quarter, they have underperformed through September.

Page 36, we do have some good news. Earnest Partners, your small cap value manager, continues to do well. Unlike Bear Stearns, that bottom left-hand chart is positive every quarter. The same holds for the quarter ending September 30th. They were up over 6.46% and way ahead of the benchmark, in the 26th percentile, and since inception at the top of the charts for small cap value managers. So very good performance from Earnest.

On page 39 is Turner, which is your relatively new small cap growth manager. They also had a good quarter, up at 7 percent, ahead of the benchmark, ranking in the 36th percentile. And since inception, they're up over 11 and a half percent and slightly ahead of median and ahead of the benchmark.

On page 43 is the performance of New Star which is your sole international equity manager. They were in positive territory, up over 8 percent; however, they did lag the benchmark by almost 200 basis points. They ranked in the 89th percentile. They did have an underweight to Japan and also to energy stocks, which lead to the main underperformance. For the full period they've been invested, which is only six months, they're slightly below the benchmark and in the 83rd percentile.

I think performance here for New Star is somewhat disappointing, but it is only six months in performance. And when the benchmark is up over 10 percent and they had a position where they just felt, like a lot of managers, that energy and Japan still -- for two different reasons -- were not attractive. Energy had played out, so they had been underweight in that for the last six months. And they felt that Japan was still not an area to be in, although it is improving there.

Finally, the next section is domestic fixed income. Page 45 is AmSouth, which is no longer a manager for you; but through September 30th, they had a relatively good quarter. They were down 54 basis points but ahead of the benchmark with their shorter duration and overweight to corporates, which helped this quarter. However, the last three years were a struggle for AmSouth. They were up 3.54% over a three-year period but lagged the benchmark and ranked in the 88th percentile. Their long-term numbers were good but, really, as a result of restructuring the fixed income portfolio, they are out. And Western, the new fixed income manager is now managing money.

On page 51 is the performance of Sterne Agee, which had a poor relative quarter, below the benchmark by 30 basis points, at negative 97 basis points. They had a relatively significant underweight to credit which hurt during the quarter. Last year, they also underperformed by close to 50 basis points. However, over the last two years and every other period has been strong, ranking over a three-year period in the 20th percentile.

With Sterne, I think that this is really just a blip on their performance track record. I know that the portfolio manager did have some issues going on outside of work, but I think it's more of a function of the fact that he had a position where he was underweight credit for this last quarter; and he also was closer to the duration benchmark, which hurt performance during this time period as well. They have lost some of the assets as we structured fixed income. They went from approximately 90 million down to 65 or so.

That concludes my report and I'll be happy to answer any questions.

DR. MALONE: Can you summarize?

MR. PELLECCHIA: Well, I think during this past quarter, we had two underperformers; and that was Bear Stearns and New Star. New Star was still up over eight and a half percent. So on an absolute basis, it was very strong. Having international stocks is very helpful for the portfolio. They lagged the benchmark by 150 or so basis points. So on a relative basis, it didn't look that good.

Everything is the same with Bear Stearns as when we hired them, except that they have hit this patch of underperformance, unfortunately, almost since the time we invested with them. Their long-term numbers before we invested, as you recall, when hired, they were very strong. They feel like the market is turning away from some of those stocks that have been rewarded for not having strong earnings. And they're looking for those that have very strong earnings and have probably ratcheted up their capitalization as well.

Sterne Agee's relative performance at 30 basis points behind is not so bad. I think right now we have a well-positioned portfolio in that we have two small cap managers who are doing well. We have a new large cap growth manager that has had superior performance before we got invested. Hopefully, they will continue. Bear Stearns is struggling, and they know what their goal is for us. And if they don't meet it, we're going to replace them.

New Star is a brand new manager, six months in. All indications are that it was just a positioning of being underweight in Japan and that they're still a strong manager. And we've repositioned fixed income to add a core-plus portfolio with Western. So I think we're doing all the right things as far as positioning this portfolio to move forward. Unfortunately, the past has not been that good on a relative basis. On an absolute basis, it's been pretty good.

MR. BUFFKIN: Where is Bear Stearns from October and November? What is their return looking like?

MR. PELLECCHIA: They're about 280 or 290 basis points ahead of the Russell 1000 value through November 25th. So I think the benchmark was up about 3 percent, and they're up about 580.

THE CHAIRMAN: Thank you very much, Bud.

Pages 22 through 28, information from the working session that was very informative with good discussion. And the recommendation was that the Treasurer meet with Council of Presidents. Dr. McGee. Dr. Malone and Dr. Johnson helped me do that. And we had a very good but brief meeting. And you see the summary of the points that I made. At this point, I believe we've only had two institutions to respond. Everybody at the table that day was positive in their acceptance of the idea.

DR. McGEE: We'll follow up, thank them for their commitment, and encourage a response.

THE CHAIRMAN: We asked them to encourage passage of our 529 legislation. We will follow up with the Council of Presidents and their lobbyist to pass the bill.

DR. MALONE: The finance committee of The Alabama Commission on Higher Education passed a resolution in support of the tax provision as well as in support of the PACT Program. And that was an addendum accompanying a resolution that went to the Governor on a unified budget in the finance budget.

THE CHAIRMAN: Thank you. Very helpful. Additionally, I'm providing to the Board, on pages 23 and 24, information on the PACT and the 529 Programs, hoping that this information might be helpful in your deliberations and in your conversations about both PACT and ACES. Any questions about this initiative?

DR. JOHNSON: Of course, it's a very sensitive area with presidents and boards of trustees, but could we consider adopting a resolution urging all institutions to hold tuition increases to the bare minimum for the next year?

MR. JONES: I agree. It at least will show them our concern, if nothing else.

DR. McGEE: Can you see anything yet in revenues for the State for the fiscal year?

DR. JOHNSON: Well, they're going to be a record high. They can expect the best year ever in the history of this state in terms of new dollars appropriated for higher education.--

DR. McGEE: I think a resolution would be appropriate.

DR. MALONE: I'd like to have us seize that opportunity. And I think, Dr. Johnson, that would be a great idea. I think that will be appropriate for us to do, particularly in light of the new revenues. And tag it back into the tuition assumption that we have to make with the PACT pricing.

THE CHAIRMAN: Suggestion well made. Staff can draft and circulate it by email to the Board.

MR. SHERLING: So move.

DR. JOHNSON: Second. I'd like to see it read something to the extent, Revenues flowing into the trust fund this year are at a record high, that we've seen tuition increases outstrip the cost of inflation in recent years, and that we would urge all boards of trustees and presidents to hold tuition increases to a minimum. We're not asking them not to increase them; but, in effect, we're asking them to do the very minimum they can do in terms of increasing tuition for students.

THE CHAIRMAN: Motion made and seconded. All in favor, say aye.
(Board members in favor of the motion so indicated.)

THE CHAIRMAN: Motion carries.

THE CHAIRMAN: The resolution could include the amount of moneys going in institutions in Alabama as a result of the PACT Program.

DR. MALONE: That was the great point you made at the Council of Presidents meeting, I thought, was to impress upon them not only are we in this together, but at the same time, y'all are going to benefit if this program is even more successful.

THE CHAIRMAN. Moving on to Agenda Item III-C, Report of the PACT Marketing Plan for '05, Deputy Treasurer Anthony Leigh will give this report.

MR. LEIGH: Page 29 is just simply a recap of our marketing efforts for 2005. We'll be in the process of putting together a plan for 2006 that we'll present to you in the spring. Also included is a sampling of press clips from the Treasurer promoting the college savings programs around the state. If there are any questions, I'll be happy to address them.

THE CHAIRMAN: Along those lines about the articles, I'll call your attention to the excellent performance of Deputy Treasurer Anthony Leigh and his associate, Jana Ingles. They do an excellent job in media relations and articles per locale in the area, and their efforts have made all this publicity possible. And it's free press, so it's no cost to the program except for the wear and tear.

Next, we'll have the presentation by Bear Stearns. Mr. Jeffrey Simon and Mr. David Silk are here. Gentlemen, welcome to the table. We look forward to your presentation.

MR. SILK: Thank you and good morning, everybody. My name is Dave Silk, and I'm a managing director with Bear Stearns Asset Management. And I look after the client service end of the portfolio.

This is Jeff Simon. Jeff is a senior managing director at Bear Stearns Asset Management. Jeff is the Co-CIO of the large cap value strategy. Jeff sits on the operating and executive committees at Bear Stearns Asset Management and is really the guy who's in charge of not only your portfolio, but building the process and philosophy and really the architect of the large cap value style at Bear Stearns. So Jeff is directly involved with your portfolio.

And what we'd like to do here today is first discuss performance - where we've been, what's gone right, what's gone wrong, and where and how we're positioned to outperform on going forward. There are no changes in team, no change in personnel, no changes in process or philosophy. So I think that that should be comforting to the Board to know that everything is intact at Bear Stearns Asset Management.

Before I turn it over to Jeff to talk about portfolio positioning, I'd like to talk about performance. And we've handed out a couple of different pieces of information, the first of which is a single page of paper as of November 25th. You can see that we've had a strong period of outperformance quarter to date, and we've able to lessen the gap year to date versus the Russell 1000 Value Index. As of 11/28, our numbers are even stronger with our quarter to date number 4.59 versus the Russell 1000 Value Index at 1.35. So we are about three and a quarter percent above the index quarter to date through 11/28. So that's good news. Year to date, as of 11/28, we're at 5.05 percent versus the Russell 1000 Value Index, which is at 7.12. So we're still shy about 2 percent, but the gap is closing. And lastly, since inception from July 20th, we are at about 16.26 percent versus the Russell 1000 Value at 21.5. So since inception, we're just over 5 percent down.

Now, we're not happy with the underperformance, and we are not complacent. That said, we are very confident about where we are and why we'll outperform going forward. And we have a large cap value portfolio positioning book that we handed out that I think Jeff is going to talk to a few pages in there and talk about how we are positioned; and as I said, what has gone right and what's gone wrong and where we are headed. Before we do that, are there any questions on the performance?

I'll turn it over Jeff to talk about the portfolio. The reason I handed out the thicker of the two books was quite simply that what we want to leave you with after we talk about where we are currently is just the reason why you hired us is our adherence to a style and to a philosophy in process. And that's what is in that client service book that I handed out. So if there is time left over, we'll take you through that; but in the meantime, I think it's well worth turning it over to Jeff.

MR. SIMON: Let's start off with the booklet that says Alabama Prepaid Affordable College Tuition Program and turn to tab two. The bias that we have as investors, we really wanted to look out over a long-term period of time. When we say long-term period of time, we're looking at business models that we're investing in over one, three, and five-year periods. Why that's important, on page 4, we invest in companies that sell at prices below our estimation of intrinsic value. What we're looking for is if we can buy a dollar for 75 cents, there's a margin of safety in there in that that dollar can grow over time for say 10 to 12 percent a year, we think a very powerful combination. If you were to go back over the last five years since 2000 to 2005, the market has had a negative rate of return still. Even though we kind of got up, down, sideways, we haven't had the range of 6 to 10 percent.

What's important to recognize with this process is that we will balance risk and reward. A lot of times when we see risk in the marketplace, it's an uncomfortable zone for many investors because they don't see the risks on out there; but our job is to go ahead and do that. And if it means that we have to give up a little bit in the short time to protect our client's capital to get the above-average returns over a long period of time, that's the only thing that we should be doing as an investor. That's our philosophy. That's our process. That's the bias that we have as an investor.

Now, we are going to invest in companies that can increase its intrinsic value over time, and time is the key. Time is the ally for a good business model, and it's the enemy of a poor one. Time is the ally of a good investment processing philosophy, and it's the enemy of a poor one. And so, therefore, the bias that we have that we're going to invest in is business models. We don't look at them as stocks. We're going to be a shareholder in a business where we, as a steward of capital, want to make sure that we are aligning our clients' needs and that the business models and the management teams around those businesses are allocating capital back to the shareholders in a framework that we think gives us above-average return and below-average risk.

So, therefore, the bias that we have is towards strong business models, companies that have sustainability to higher returns and can generate high levels of free cash flow. With that, there are going to be some business models that we won't invest in because, one, every four years, they may earn some money. They may be able to pay a dividend. They may be able to buy in some stock for the next three or four years because of structural impairment that they had, either in the industry that they're in or the business. They can't do it a sustainable period of time. And we don't want to get caught into what we consider as value traps.

Page 5 is just the four-step investment process that we have. We are a large cap value manager. We start off in the universe of about 2,000 companies and distill it down to 300 to 400, based on capitalization and valuation screens. And the second one is how we differentiate ourselves, which is making adjustments to reflect the real business economics. Wall Street, as well as many investors, tend to take as gospel what they see are the facts. And it's not. What we have to do is really scrub it down to make sure that we're getting the highest quality businesses, the highest quality earnings in cash flow, the highest quality management teams, and buy them at a discount when it's presented to us. So, therefore, we're only going to make an overweight investment decision into certain areas or we're going to invest in certain areas when it's lined up the risk in return for us. When it's not, we're not going to.

And sometimes that's the hardest thing. You have money in your pocket and you want to spend it. That's not the way to go ahead and be successful over the long term. The way to be successful in the long term is to identify great businesses and buy them when they've been priced appropriately. You want to make sure you have business models that are going to work for you year in and year out. And sometimes when investors don't have that conventional wisdom to see the opportunity its created, that's when we can make the overweight investment decision. And that's what we've seen as we've gone through this investment process.

Nothing else has changed at all for us as we've gone through it. The most important thing that has happened as we've gone through it is that we've able to have the highest quality portfolio. This is the highest quality portfolio that I've seen in three decades, the ability to be able to buy these companies at below-average prices.

Now the question becomes, if the process leads you there but nobody sees it, what do you do? Well, investing has a behavioral finance aspect to it. There's a fear factor. If nobody else sees it, whey would I want to invest in it? That's our mission. We don't want to be in the line where everybody is. We want to be able to get to the checkout first and get out, go ahead, and move on. So with that, let me turn to the current positioning of the portfolio.

Pages 1 and 2 talk about performance over a long time frame. Many of our clients that have been with us for the decade have seen periods where when we think risk is too high, we're going to shy away from the risk. And that may hurt us in the short term, but they've seen the rewards over time for that philosophy. So it's very understandable to them as to what we've done here over the last 12 months. To newer vintage clients that haven't gotten through it, it's important to let you know that we have seen this before. This is now the third time in the last 14 years of the product where we have made a decision which is very different than what everybody else sees in a 12-month period. And yet, when you look over the next one, two, and three years and you kind of stand back and look at it, you couldn't tell that you went through that 12-month period of challenge, and all you see the reward.

It's important to tell you now up front that we think the period that we are in and the period that's in front of us is going to be most likely a period of excess return to the portfolio. We actually believe that we're going to have above-average performance. And when we come back a year from now and two years from now to discuss that, I'm going to remind the Board again when we've had this exceptional return, don't go ahead and extrapolate that, that we're going to get back to normal, too.

Let me turn to page 3 that will highlight that comment that I just made. And this is as of September 30th. So remember, you don't have the recent improvement that has taken place during the fourth quarter. And I think it even makes it more relevant. What we did is we went back 15 years. And the question is, how can we once again get out and tell our clients that we've been here before? The challenges are always different, and the outcome is always the same. So we were able to break down what we consider to be periods one, two, and three.

Period one is the period of around 1998 to 2000, which many of you remember was the internet revolution. And companies were being valued based on eyeballs, not customers or earnings or cash flow or anything like that. And companies and investors were very comfortable paying a hundred times earnings for it.

And the question that we were getting back in March of 2000 was, don't you get it? There is a new economy and an old economy, and you don't own any of these new economy companies. You don't own Microsoft, Johnson & Johnson, Proctor & Gamble, General Electric, Dell Computer. And the list went on exhaustively. And we said, we're not opposed to the great business models, but we're not going to pay the prices that these investors are willing to pay. And we suffered, and we underperformed by a thousand basis points over a 12-month period -- that's period one -- right up to March 10th of 2000.

And then the world started to recognize what seemed to be in hindsight pretty silly, but at the time seemed to be conventional wisdom. And within the next 12 months, we outperformed by 3800 basis points, 38 percent versus the marketplace. And we continued to pile on the points over the next three years to where we were in January of 2004, which energy had gone from 18 to $22 up to that $42.

Many of the energy companies that we bought in 2002 that were significantly undervalued appeared to us to be fairly valued, not overvalued. So we started to sell our energy position. We didn't go to zero, but we started underweight. And we found other exceptional investment opportunities. And the world disagreed. And the price of oil went from 42 to 52 to 62 to right into September of this year to $70. And I kept the report written by a major Wall Street firm that the low price for the next decade will be a hundred and we'll average $200 of oil. He could be right. We could be wrong. Maybe we are going to average $200; but if we do, I think it's going to impact the consumer. And it's going to impact everything that we do collectively.

Wall Street disagrees with that, by the way, that the price can go to 200 and everyone is going to do fine. Like I said, we could be wrong; but we don't see it that way. But more important, what was being priced in the marketplace? There was a group of business models that were being priced for failure, and we're going to highlight those for you in a second.

So in this period three, we had underperformed by that 900 basis points over that 12-month period. And now we've picked up about 340, as of this morning, in eight weeks. And for us, if you go back to period one, you haven't even gotten back to the zero line. If you can kind of think of this behavioral finance bottom here where it dramatically drops off and then you just start period one moving back up, we haven't even gotten back to the zero line, which is just starting to get to fair value, not even getting a revaluation. That's what we believe is in front of us.

Page 4, there's a couple things on this page, and then we're going to go right into your portfolio so you can see where we positioned it. This really stands out. Mr. Greenspan is going to be leaving the Federal Reserve, retiring in January. Dr. Bernanke will be taking over. But we look at that position as the referee of the capital market. And back in '98 through 2000, Mr. Greenspan was saying we're in a period of irrational exuberance and investors had taking inherently more risks and not being compensated for it. This is a way to say it. And the world disagreed with him. We saw it from the bottom on up, and the world disagreed with us for a short period of time, for 12 months, then changed pretty dramatically.

Now we dial forward to this period of underperformance that we've had. And in July of this year up in Wyoming, Mr. Greenspan said that we're in a period now where investors have a lower compensation for risk, the lowest level he's seen in five decades. Investors don't seem to want to embrace once again that the referee is saying there is a foul being committed here and you need to pay attention to that. At some point in time, the markets will go ahead and come back to rationality. And when they do, there will be a penalty to be paid for having taken risks and there will be an award for having taken quality.

On the quality spectrum, turning to page 5 -- this is your portfolio and the way you're positioned -- we're overweight where we consider a high quality. And we put in a category of mega cap companies. What that means is that if you were to take a look at us versus our peer group -- and we've heard this from many people that observe us -- we certainly are different than most investors out there in how we're positioned, not only the names that we own, but in the largeness of the companies. And we think that's a great asset and opportunity for investors right now.

The reason why it's being created is probably threefold. One is the price of oil went up to $70, so there's a belief that large companies can't adjust to that in a short period of time. We've had, unfortunately, some miscues by corporate managements, whether it's Adelphia or Tyco or Enron or WorldCom, where investors still remember the evils that corporate management have done in large companies. And Sarbanes-Oxley, which really puts fair disclosure in front of all of us, and investors having a problem with what they call a complexity trap that a business that has several divisions is much harder to understand; a business that is global scale is much harder to understand.

The curiosity factor is for us, when we take a look at it through a methodology, which is really getting into the business dynamics, for the first time in 25 years that the largest companies, the highest quality companies if you think of them as AAA rated bonds, they are selling at a premium to the marketplace in valuation. What that means is the market doesn't believe that these great companies will remain great. As a matter of fact, the market believes that the next ten years will be this degradation curve where they will just do everything they could possibly do wrong. We disagree with that categorically.

Therefore, we're underweight energy. We're underweight utilities. And it's based on valuation levels, the ability to generate free cash flow or a durability not to generate high levels of free cash flow and the long-term history of these companies not to have major share or purchases weighted to it.

Let's turn to where the mispricings are. On page 6, when we take a look at the extremist pricing in the marketplace, we've gone back over 20 years. It's looking at what we consider the relative PE or its valuation levels. How do you compare one company versus another company? This is the largest 25 companies in the S&P 500. And what you have here is right now the market saying that we distrust these companies for whatever reason and we're going to value them at the lowest values that we've seen in two decades.

What's interesting is if you went back to 1999, 2000, the high point here, the high water mark, all the companies today that are being distrusted were all the companies that were being trusted. Now, back in 1999, 2000, these companies were selling at 50 to 100 times earnings, and today they're selling at 12 to 14 times earnings. So they're selling at 75 percent discounts to where they were, and the earnings have doubled during that period, and the cash flows have doubled, and the returns on invested capital have moved up.

So where is the distrust? If you actually look at it and take a look underneath the hood, you would say this is high quality. The market is saying we're not even going to raise the hood; we're not looking underneath that because everybody says it's not; that's what we believe. We said, that's a good starting point. Let's really challenge ourselves. Remember, we're looking at companies from bottom up.

Page 7. With the help of the -- and this is one of the things that we always talk about. We have to be intellectually honest. We do about 85 percent of our own research internally, but we have to be cognizant. There are some very bright people out there that do independent research, and we want to take advantage of that.

Mike Goldstein was at Sanford Bernstein, who is the strategist there. And he has a very comprehensive database. So we had him in and we asked the question, Mike, if we went to the end of World War II and we took a look at all these companies in the same framework, how extreme is the mispricing that we're seeing as we go through company by company? Could you take a look at that for us? He put together a recipe of about 100 ingredients that look into it to look at it in a different way, and this is what came out of it. To the far right-hand side, you'll see a floating dot. And what that says is that the universe of the highest quality companies is selling at the lowest valuation since the end of World War II. The last two times that you had an opportunity to buy this type of quality spectrum was back in 1998 when Russia was considering to default and long-term capital almost took the financial system down and Mr. Greenspan had to start cutting rates rapidly to save all the banks. And back in 1969, 1970 was very different: supply and demand with an oil embargo. You couldn't get petroleum products. Now you can get all you want; the price is just very high for it.

What is curious is when you look at this valuation, the group that we're talking about that is mispriced today at a 50-year low, if you went back five years ago, it was at a 50-year high. That is what has happened here in the last five years. The market has gone sideways. The returns have basically been negative, but it's been the two largest momentum markets in 50 years. People pile onto one thing; they drive themselves out. They pile into something else; they drive themselves out. That's unusual. That usually doesn't take place in a short period of time; but when it does, it's an exceptional opportunity to generate excess return as long as you're willing to say, I'm not going to take the risk unless I'm absolutely getting compensated for it. And when I do, I'm going to go ahead and have an overweight investment decision, and there's going to be a lot of excess return generated which is --

Page 8. The concern was and the hope was that we could at least pick up 500 basis points from that September period. So we've picked up about 70 percent of that first installment payment. And when we look at the 500 basis points, that's not the end of all, for us to have made this overweight investment decision; we want to multiply it on top of that. If we knew we were going to give up 1000 basis points to have lower risk, then we want to get 2X, 3X, 4X or 5X that return. And now we're getting it.

If you look at your portfolio, approximately 40 percent of it now was overweight in the highest quality brands in the world. And the Russell 1000 value index disagrees having those companies in there. It's Wal-Mart. It's Home Depot. It's General Electric. It's Proctor & Gamble, Johnson & Johnson, IBM, Microsoft, First Data, Anheuser-Busch, Oracle, and Dell Computer. The greatest brands in the world are selling at a 50-year low.

Now, our process is excellent at identifying where the mispricings are. It is a little challenging to say, you know, it has to happen in a 90-day period when you've gone to a 50-year low, that it's going to happen guaranteed in the next six months; but hopefully, this first installment payment over the last eight weeks is getting us to that period. We look at it as we've gone ahead and bought an insurance policy, paid a premium, and certainly wouldn't want to go ahead and cancel it just as we're starting to get paid.

What we're finding right now is that our expectation is that this portfolio's earnings per share growth, which is to the far right-hand side, will be about 12 percent compounded from here, just the earnings growth. The portfolio is underpriced by about 25 percent, just to get back to fair value. So if you took 25 percent and the mispricing of the value, you could grow it 12 percent off of that. And the implied growth rate in the marketplace is about 6 percent. So we're looking at we think we can double the returns for the market compounded quarterly and annually for the next five years.

We have not been able to make that statement to our clients since inception. This is absolutely unprecedented that it is just that laser focused what we can go ahead and deliver. Usually what we say is we want to be able to do better than 200 to 300 basis points a year, you know, compounded on the benchmark; but right now, we've been given a pretty exceptional opportunity.

The last 12 months, to your point, yes, we had to go ahead -- it would have been great to have bought all these companies on the same day all in the last two weeks and said we've identified all of them and they are all going to sell at a 50-year low at the same time, but they didn't. It's been in an accumulation phase, starting from Wal-Mart and Home Depot and General Electric.

It's almost as if every quarter Wall Street becomes disenfranchised with a different business and they say this is on sale now. What is it going to do? The process is telling you when it's on sale to continue to buy it. And then I'll go a little bit further out on the limb because I think it's important to be honest with our clients. It would be very unusual for us to be able to own these high quality companies in the next five years. They shouldn't be mispriced like this. There's no way. These companies are going to go ahead and be priced like they always have historically at a premium to the market, usually at 30, 50, 100 premium to the mark; and we're going to sell them because they're going to be valued at premium. And we'll find --

DR. MALONE: If I may, I'm looking at the ten largest holdings, and it pairs up with what you're talking now, and all but three are in the negative. And some of these are on your ten worst performers through September 30. I guess the concern that we are all sharing is that we're looking at these exact numbers through the last quarter. And you are saying -- I think I hear you saying -- have some faith and we're on the right track and we're going in that direction.

MR. SIMON: More than having faith. We're getting our first installment payment. And the reason why we've picked up 338 basis points of the 500 is from these companies right here.

DR. MALONE: Over time, because it seems like you have seven-year cycles based on your philosophy. I guess what we've got to look at and must look at, not only in the short term, but also your performance over time that allows us to have confidence in taking some of the ebbs and flows out and moving more straight line.

MR. SIMON: We have a chart that we usually put in here for the traditional quarterly review, and I'll get that sent to you this afternoon. It's a three-year rolling performance that we have. And it shows, even with the ebb and flow that we've had for the last five years -- it's very unusual, by the way, to have two markets like that in a five-year period -- the three-year rolling number is very smooth. And what you find is that very consistently outperforms by 250, 300 basis points on every rolling three-year period. So that takes into account mistakes. It takes into account wild volatility in the marketplace. And it takes into account highest valuation known to man that took place in 2000 to the largest mispricing in 50 years.

I think the bottom line is simply this. We need to outperform in the short term and in the long term. And if we don't perform in the short term, there is not going to be any long term. So you know, I had an old coach that used to say, don't tell me, show me. We understand that. The reason why we showed you the latest and most up-to-date performance was to give you an idea that we are starting to get rewarded and it is starting to work. The portfolio positioning is starting to work. So we're at the beginning of what Jeff and his team feel is a real solid stretch of outperformance. And we realize that's what we're paid to do and that's what we need to do or else, you know, you need to find someone else that can. And we understand that. We clearly understand, you know, what our goal and what our expectations are.

MR. SILK: I just want to be clear here. We fully understand what our expectations are, but we didn't want to come down and leave here without hopefully giving you an idea of why Jeff's portfolio is positioned the way it is and why he's so darn confident that we are going to outperform in the short term.

MR. SIMON: We certainly appreciate your mission here on this board and what the goal is and the challenges over the last 12 months. I can say for myself I've seen about 80 clients since April, and the concerns that you have are valid. The thing that I would tell you is that most of the boards, as we go through it, say, you know what, why don't you own more energy and own more utilities? And when you hear pretty much uniformly that everyone says, well, why don't we own more of this; well, why do we want to own these companies; and then you take a look at your peers that are investing and they're doing the same thing -- it doesn't take much when everyone is on one side of the boat to happen. Either the boat is going to turn over, or the people are going to realize the boat is a little rocky on that side and get more to the middle or start to come to the other side. It's very unusual to be able to position a portfolio with the highest quality brand names in the world. It's unprecedented for a large cap value manager. It may be for other disciplines over time.

And the one thing that we are very sure of is that commodities -- there's a reason they are called commodities. They don't remain at that type of return for a lengthy period of time. There's going to be ebbs and flows, to your point before. And the market right now is extrapolating the most recent information over the longest period of time. And the uniform question that I've heard from every board -- and I'm sure you have the same question -- well, look at this portfolio and, you know, interest rates are rising; why do we want to be in large cap; why do we want to be in value; and why do you want to own these companies? And the way that we look at that question is this, that we can say the Federal Reserve is raising rates or you can see that the Federal Reserve has been raising rates. We're in the camp after 12 interest rate hikes that the market is starting to look through, that there is going to be a different economic backdrop. There is going to be a different list profile to invest in, bonds and equities and real estate. And that's what's happened in the conundrum Mr. Greenspan identified.

So, to your point, the demarcation line has been set. We're seeing the returns here. And to the rest of the boards' point, we certainly believe it's going to happen, the relative outperformance. We're wishing the next 90 days, but it could be 120 days. And we could pick up 499 basis points out of 500 by March. So we would just hope that there is a certain good will that we can build for you as we kind of approach this March deadline; that as you see more and more improvement, that you remember we've been true to the process.

DR. JOHNSON: One of the points that were made this morning was that from September 30th to the end of November, things have dramatically improved. Can you, before we approach that March deadline, give Ms. Ivey an update on what those same numbers look like at the end of January? That way she can circulate it to the Board.

MR. SILK: Absolutely. And we'll get you a full attribution and commentary so you don't have to decipher it all.

THE CHAIRMAN: Thank you very much.

MR. SIMON: Thank you for your time.

THE CHAIRMAN: Next we have a discussion of open meeting legislation. Mike Manasco, legal counsel to the Treasurer. Mike is very knowledgeable about this, and will give us a brief overview.

MR. MANASCO: Act 2005-40, Opening Meetings Act. It became effective October 1. We are working on the action points that we need to do which is establish and adopt internal procedures that will assist us in meeting the requirements of the act, as well as general board procedures.

The act defines what a meeting is as a prearranged gathering of a quorum of a governmental body, a committee, or a subcommittee that's regulated by time and place set by law. And it also includes the same kind of gathering of a body or committee or subcommittee to discharge its duties, such as exercise powers to approve the expenditure of funds. And for our purposes, it also includes a gathering whether or not it is prearranged or required by law of the body or committee or a subcommittee to deliberate on certain points; and that at the time of that gathering, the participating members expect that it's going to come before the entire body for a decision immediately after the discussion or at a later time and deliberation.

What I just talked about really is a working session or investment policy committee when you deliberate to exchange ideas, facts, and information that is expected to influence how the whole body would vote to approve or disapprove at a time immediately following a meeting or at some later time. So, obviously, for the act to apply, you need to have a quorum and you need to be doing something in the form of deliberation. If you do not expect something to come before the entire body, it would not necessarily be a meeting that would be covered by the act.

So what is the bottom line? If there is a meeting of the body, a committee or a subcommittee covered by the act, what happens? One, the law requires that you give notice. And, two, it requires that you make a record of the meeting, like taking minutes and making them available to the public. And thirdly, it is that if you are having a meeting, members of the public can come and record that meeting. And we'll establish policies for that.

Executive session is another big change. You can go into executive session for anything but discussing someone's job performance. Anything related to job performance is going to have to be part of the open meeting.

MR. SHERLING: Would that relate to the job performance of our managers?

MR. MANASCO: No, I don't think it would relate to the job performance of a manager. It relates to the job performance of a public employee.

DR. MCGEE: What's the impact on conference calls?

MR. MANASCO: If you have a quorum on conference call and you're discussing something you expect to come before the Board for a decision at a later time, that is going to be something that is going to have to be noticed and the public have an opportunity to attend.

DR. McGEE: So conference calls are going to cover informational items --

MR. MANASCO: Yes, sir. Any other questions?

THE CHAIRMAN: Thank you, Mike. We'll certainly be developing the procedures and sharing with the Board. Our next business is Decision items. The first one is page 46 and 47 – the consideration of approval of the building fee for two year colleges.

DR. McGEE: Madam Chairman, I'd like to move adoption.

DR. MALONE: Second.

THE CHAIRMAN: Any discussion by the members of the Board? We want to thank Dr. Johnson and Debbie Dahl for providing us clarity on the subject. All in favor say aye.

(Board members in favor of the motion so indicated.)

THE CHAIRMAN: All opposed, say no. And the motion is carried.

Agenda Item IV-B, resolution for exceptions to investment policy, page 48 through 50. Bud ..

MR. PELLECCHIA: This is the diversification wording section with regard to Intech. Their strict mathematical trading strategy has guidelines in place for themselves that don't necessarily match our existing guidelines. And they've asked for an exception surrounding number two of our domestic equity guidelines, which say that they can have a stock in their portfolio with less than three years of operating history if it is part of the benchmark that they are trying to beat. I think that's appropriate. And I think, to tell you the truth, it applies for all our managers. If we're trying to allow them to beat a benchmark, then even if that stock has less than three years' history, if it's in the benchmark, they should be allowed to buy it.

With regard to number four in your diversification guidelines, Intech has asked for an exception to allow them to invest in a sector or a security that may have differences in our guidelines as it relates to sectors and individual stocks. And it would allow for Intech -- where it's really constrained is on the individual security of 2.5 percent of the relative weight in the benchmark. Again, this is a diversification guideline. It is another way of approaching it. And I think if we want to invest in Intech with their strict mathematical and their trading process, it would be too problematic for us to put forth our guidelines and be strict about that. So I think that it is appropriate to allow this exception for Intech only. And that would be on four, for Intech only. And number two is for all managers.

DR. JOHNSON: I move adoption.

MR. SHERLING: Second.

THE CHAIRMAN: All in favor say aye.

(Board members in favor of the motion so indicated.)

THE CHAIRMAN: All opposed say nay. The motion carries.

The next business is consideration of a resolution to issue an RFP for a domestic equity large cap value manager, page 51. Bud.

MR. PELLECCHIA: As you know, we are giving Bear Stearns a set limit on their performance to improve. In the meantime, we are proposing to draft and issue and RFP so that we can be ready with a new manager if Bear's performance does not improve.

MR. JONES: Move for adoption.

MR. SHERLING: Second.

THE CHAIRMAN: All in favor say aye.
(Board members in favor of the motion so indicated.)

THE CHAIRMAN: The motion carries.

DR. MALONE: I have a question related to that. When we talk about improvement and expectations of improvement as we monitor the monthly reports, will you be prepared to better define improvement in terms of your professional expectation?

MR. PELLECCHIA: Right. A lot of times people say we're going to watch this manager, but we don't put a specific goal in mind. I suggest a goal for Bear of 500 basis points. Now, if they're short by five or ten basis points, that doesn't mean we have to fire them. So yes, I would give my expert opinion at the time, but I wanted to put a quantitative goal in mind.

DR. MALONE: Thank you.

THE CHAIRMAN: Item IV-D, valuation assumptions and consideration of resolution. Bob Crompton, our actuary.

MR. CROMPTON: Thank you. I will be as succinct as possible, but as verbose as necessary. The first assumption that I have in the charts before you is the assumption on tuition inflation. And if you'll turn to page 58, you'll see that I am recommending that the assumption be changed from 7.5% to 7.25%. I have some historical backup in the earlier charts that show the year-to-year, two-year and four-year inflation numbers as well as the aggregate inflation numbers for the weighted average tuition. And you'll see that the most current results on page 55 are long-term average of the aggregate WAT. The weighted average tuition is 7.08 percent. And actually, it's a little bit lower than that; because when I put this together, I used the weighting of enrollment from last year. And we would actually have a smaller four-year increase.

I also assumed that we would have an overall 2 percent increase in the two-year tuition numbers for 05-06, but that did not happen. So the two-year number will change because of changes in the enrollment weightings, and the aggregate number will be something lower than 3.27. If you turn to the next page, page 56, there is a graphical representation. There is a solid line running at 7.08 percent numbers, the long-term weighted average tuition increase. And then the dashed line is the year-to-year change. And what you see is if we had taken this look last year, we would have been on top of the mountain, looking backwards. And if you turn back one page, that 7.08 percent would be something higher than 7.25 percent. As an actuary, what this tells me is that the series of inflation numbers is still unseasoned, and we have to be careful where we take our average. We have to make sure that we are not picking up too much of the high cycle and not enough of the low cycle. And I've summed this up on page 57. The inflation numbers that we've seen the last two years ending in 04-05 is a short-term spike; and that for the near future, what I'm anticipating is a period of moderate increase.

We do have very strong economics at the state revenue level which we anticipate to flow into higher education appropriations, which really drive the numbers that you see before you. Overall, in the long term, I do anticipate periods of both moderate increases and spikes such as what we have seen recently; but the real story is that the historical average that we're looking at right now remains a reasonable guide to setting the assumptions. That leads me to the 7.25 percent, the average plus a little bit of conservatism there. So 7.25 compared to a prior assumption of seven and a half compared to current long-term average of just under 7.08 percent.

DR. MALONE: I really think that in our state, we have an undervaluation of higher education. And I know that's certainly the case in the Troy system. And it's very difficult for a CEO to talk to his or her board about let's now value our product on a higher basis than we have because, again, we're a poor state. But I really think what's occurred now is your institutions, particularly your regional institutions, are more accurately valued in their tuition and fees. And at the same time, we are now a little bit prosperous as a state. So I really think these are harbingers for reasons to support your assumptions, in particular, the relative prosperity.

But if you argue it, okay, we're going to go back into a recession or we're going to be in proration in '08 or '09, I still think that that other factor of proper valuation of product is probably going to militate against those big double digit increases that maybe we've seen in the past. It's a little bit harder to quantify what I'm saying. A lot of this is more psychological; but I do think the CEOs, at least in my watching in the '90s and early 2000s, have really tried to come to grips with that notion.

MR. CROMPTON: Thank you, Dr. Malone. Just to give a little further explanation of that, if you look at the chart on page 56, what the 7.25 percent assumption says is that if we cycle through exactly what we've had shown here, the 7.25 percent will be more than adequate over the future. Of course, no cycle is exactly the same, but there are similarities over time.

The next assumption to consider is the investment return. Pages 60, 61, and 62, shows historical results. And on page 62 through last year, our result is 9.02. Of course, I understand from the earlier presentation that that average is going to be slightly higher than the most current year's results. Now, Bud mentioned at the working session that his best outlook for the next five years is 7.88 percent. My recommendation, beginning on page 63, is that we bifurcate the current assumption into a short-term and a long-term rate of return. This is an approach that's been used in other states and captures both the current investment environment and long-term expectations reflective of the program's strategic asset management.

In turning to page 64, specifically, I'm recommending 7.88 percent for five years based on Bud's recommendation, combined with a move to 9 percent beyond five years based on actual historical returns; but I would certainly value any comments that Mr. Pellecchia has to make regarding the return beyond five years.

MR. PELLECCHIA: I would agree if we had a 20-year time horizon that it would be higher than 7.88. Looking historically, we certainly have achieved that with this asset allocation, so I could support that. But I do think over the next five years, it would be something more like 8 percent, 7.88. That does assume index performance. We are hoping to get a premium on active management. We haven't gotten that in the past, but our hope is that we will get some premium on active management. So I am comfortable with 7.88 over the next five years.

DR. JOHNSON: If the number of enrollees continue to lag behind historical assumptions and the payouts continue to reflect the 7.25 projected increase, then the size of the fund will shrink. If the buying power of the fund shrinks, will that impact the longer term proposed assumption of 9 percent?

MR. PELLECCHIA: Not unless you change your asset allocation. Less assets is considered in the actuarial assumptions outside of the investment return. But I think if you continue to sell less contracts, that is an issue; but it doesn't impact investment return.

DR. JOHNSON: I'm comfortable with the current assumption and I'm comfortable with the 7.88. I think if the trend line continues and we sell less contracts, we've got less margin of error and making a long-term assumption beyond five years gets to be a little bit more difficult. I'll just point that out.

MR. JONES: But based on the data you're giving us, our compound average at 9.02, we don't have much room for margin of error. I would feel a little more comfortable even if that was down to 8.75 just to have some room for error.

MR. CROMPTON: Certainly, from a practical standpoint, as you're considering this, there is not really much difference between a 7.88 and an 8.00 return for the next five years, 12 basis points, for a five year period. It's really within what I would consider the cone of uncertainty; that is, it could go 12 basis points either way. And as far as I am concerned, that would be within a margin of error that is fairly normal for an actuary.

MR. JONES: Bud, I think the Board is comfortable with 7.88, but give us a view of being a little more conservative on the long term. Is there an argument to be a little more conservative?

MR. PELLECCHIA: Yes. You know, the 14 and a half years since inception of this fund participated in one of the greatest bull markets that we've ever seen. So that 9 percent could be skewed. And the 20-year horizon, going forward, especially if the next five are at 7.88, 9 percent may be high. The last 20 years or the last 15 years are not reflective of what the next 15 years are going to be. So if it was up to me, I would probably be comfortable with 8.25 to 8.50.

DR. JOHNSON: The thing that concerns me is that we had that 14 years of really good, strong market, and it parallels the strong growth in sales of contracts. And so you have more dollars to leverage every year. Now, we hit the point where payouts are high, sales are low. And it's seems to me that we ought to take a more conservative view of the long run. I think the short term is fine. I think the spike in the economy and the assumptions there are okay, but over the long haul. I'd recommend we go to 8.5 and revisit it every year.

THE CHAIRMAN: So we have 7.88 for five years and for long term 8.50 and we revisit annually.

DR. MALONE: Second.

THE CHAIRMAN: Any discussion? We're going to adopt this in the resolution, so we've got a consensus on that at the moment. So we don't need a particular motion.

DR. CROMPTON: The next item on page 65 is the two-year college participation. This one is the most difficult to explain, so I ask you to bear with me. As you know, the actual hours of two-year participation have been running at just over 15 percent of total hours being paid out, 15.1 percent. And that has evidently been very stable over time. The difficulty is that we have to be careful that we're not comparing apples to oranges.

If in every future year we have 15.1 percent of hours being two-year college hours, what that means really is that rather than having the first two years of benefits being two-year benefits at 15 percent, it means that for all four years, actually four years and a half, we would have 15 percent of our participation being at the two-year college level. The difficulty that we have is that we have some people who are receiving benefits in their first year of a university, some in their second, and so on. The way I did this analysis is I looked at all of the depleted graduated and expired contracts, those people who used up all of their benefits, so that I wouldn't be looking at people who were particularly through their use of PACT credits and to make sure that what I was looking at really was consistent for all the people that I was looking at.

For all of the contracts that had used all of their benefits, the two-year college participation rate was 8.2 percent. Now, that 8.2 means either that every year, all four and a half years, we have 8.2 percent of the credits being used being two-year college credits. But we don't really anticipate people to use two-year college credits for four and a half years of their college career. So I translated that into the usage that's equivalent over the first two years of their college career. That equivalent percentage is 17.5 percent compared to the current 15 percent. So my recommendation is that we increase the two-year participation in the first two years of benefit usage from 15 percent to 17.5 percent.

DR. JOHNSON: That's probably an accurate assumption. You could expect modest growth as the students learn more about the articulation agreement, the fact that they can get their hours at 50 cents or less on the dollar.

MR. CROMPTON: The next assumption is bias load. On page 66, it says that this is still the analysis stage. I do have some handouts that I will distribute at this point that talk about historical results on the bias load. Let me recap what the bias load is all about. When we calculated the weighted-average tuition, we use actual in-state resident enrollment for undergraduates to determine the weighted-average tuition. However, we do run the risk that our beneficiaries will use their benefits at, say, Auburn and Alabama and wind up with benefits that are greater than the weighted-average tuition. And that's what we are attempting to recognize, that we're recognizing a risk in the bias load.

And the current assumption of 5 percent bias load means that when we pay out a credit hour of benefit, we're paying out at WAT times 1.05. That is we're paying out at 5 percent higher than the weighted-average tuition. I have assembled some stats that show for academic years 1994-95 through 2004-05 what the actual payout per dollar of credit usage is compared to the WAT for that year. And you'll see that it starts low. It starts out at 4.4 percent, and it grades up to 10.7 percent for 04-05 with an average of 7.8 percent.

The assumption currently is 5 percent. Because the 7.8 percent is relatively close to the 5 percent, my recommendation at this point is to retain the 5.0 current assumption but revisit this every year because we do have an upward trend.

DR. JOHNSON: Dr. Malone, do you see the trend continuing unless something politically happens for the four years, continue to really aggressively recruit the out-of-state students?

DR. MALONE: Yes, I do.

DR. McGEE: And, also, it's kind of unique that we don't cap enrollments in the state. Most states would cap enrollments at the flagships and the regionals, and that disperses the enrollment to all the state's colleges and keeps the numbers even. As long as you let the number grow, they're going to keep growing.

MR. CROMPTON: The next assumption that I'm showing is the split by semester. This is one that perhaps we haven't talked about much in the past. On page 68, you'll see that the current assumption is half of the benefit for years paid in fall semester and half is in the spring. On the preceding page, I show what the historical trend has been. And there is a sizeable participation in summer school for PACT beneficiaries. And if you'll look, you will see that that has bounced around between 10 to 12 percent.

Also, there's an interesting trend on the fall participation. Currently, it's at 46 percent, but you'll see that that's actually increased over time. My presumption as to the pattern you see for fall is that we've had a decreasing number of beneficiaries go to schools that have a quarter system rather than a semester system; because the way I counted these, winter quarter, spring quarter, spring semester are all counted under winter/spring here while fall would be fall semester, fall quarter.

So given that, my recommendation is that we change from 50 percent fall semester, 50 spring semester to a 45/45 fall/spring split with 10 percent for summer school.

DR. MALONE: Help me understand where that variable factors in.

MR. CROMPTON: It's a minor factor, but it does affect the assumptions on cash flows and when we pay benefits. As does the succeeding assumption, which is our average payout months. On page 70, you'll see our current assumption is September 1st for fall semester, February 1st for spring semester. I've included history on page 69.

And historically, we've paid out a month or two months or even three months later than the September 1 and February 1 date. So I'm recommending a change to November 1st for fall semester, March 1st for spring semester, August 1st for summer semester. The invoice dates are incredibly advanced past the enrollment date which is reflected in the dates the invoices are being paid.

DR. JOHNSON: Have we disadvantaged a student in a serious way by holding their money?

MS. EMFINGER: We don't hold it. It's just that the college doesn't bill us until after the drop/add period, and then have to verify hours and such prior to billing. So by the time they get the bill to us, it's very late in the semester. And, we pay the bill within days of receipt.

DR. JOHNSON: I'd like to know a little bit more about how PACT benefits work towards a student on scholarship. And I'd like our staff to ask the universities and make sure we have some report on students that earn scholarships that are tuition scholarships, when are they entitled -- how do they get their money and when do they get it. Are we running a semester behind in giving it to them? And is that fair to families?

MS. EMFINGER: As soon as we get an invoice, it's paid within a week to ten days.

DR. JOHNSON: I'm not faulting us. It actually helps us for the college to bill us late because we keep the money and earn more. I'm just simply saying timely billing by the university at the end of the drop period for a two-year college might be getting their money the first of October rather than the first of December. And I don't know that that's fair to students. I may be trying to solve a problem that doesn't exist.

MS. DAHL: I don't know the answer to your question, but I know I stayed on some of our colleges for billing late just from a cash flow basis. I can't answer the student end of the question, who gets a scholarship; but some of our offices bill later than they should be billing.

DR. JOHNSON: Let us try to take that up at the Council of Presidents.

THE CHAIRMAN: On the recommended assumption for payout, we agree with the recommendation?

DR. JOHNSON: Yes.

MR. CROMPTON: The final.assumption is the contract cancellation assumption. You'll see on page 72 that the current assumption is no cancellations through ninth grade, 1 percent tenth graders, 2 percent eleventh graders, 3 percent twelfth graders. On the previous page, page 71, I've come up with the historical experience over the last year or so. Rather than based on grades, based on year from the purchase of contract, since the cancellation experience does seem to vary with the length of time from purchase. And you'll also see that I've split it out between type of payment because those who pay a lump sum typically have much lower cancellations. Those who buy on an installment plan, be it the five-year or the extended payment plan, do have somewhat higher cancellation assumptions. And I'm recommending the assumptions that are somewhat smoothed out based on our experience. You'll find that recommendation on page 73. I realize that in the overall scheme of things, the cancellation assumption will have perhaps a very small effect on financial results. Nevertheless, this is my recommendation based on experience for your consideration.

DR. JOHNSON: I move we adopt the assumption.

MR. SHERLING: Second.

THE CHAIRMAN: The resolution calls for two other categories to be considered that we've not discussed yet. One is death and disability, and the other is number of hours and benefits used.

MR. CROMPTON: I'm recommending that we have no change to those from the current assumption. Death and disability, we currently have a zero assumption. The experience that I've seen at almost every plan is that reported deaths and disabilities are vanishingly small. The other assumption has to do with the number of hours used, 128 hours. The historical experience indicates that 128 hours is approximately right for people who have used their benefits to date, those who have depleted, graduated, or terminated. So my recommendation of those is no change.

THE CHAIRMAN: If you will follow along with me, let's look at pages 74 and 75, investment return. What we have at this point is 7.88 percent over five years and then 8.50 thereafter. Tuition increase is 7.25 percent. Number of hours of tuition is 128. Enrollment of PACT beneficiaries, 17.5 for two-year colleges. Contract cancellations as recommended by the actuary. Payout on tuition and qualified fees will be November 1, March 1, August 1. Death and disability, zero. Bias, 5 percent. Semester split, 45 percent for fall, 45 percent for the spring, and 10 percent for the summer. Is there a motion to adopt?

MR. JONES: I move we adopt the resolution as read.

MR. SHERLING: Second.

THE CHAIRMAN: Is there any discussion? All in favor of adopting Agenda Item IV-D say aye.
(Board members in favor of the motion so indicated.)

THE CHAIRMAN: All opposed? Motion carries.

Next item of business is meeting dates for '06, and they are before you on page 76. If those meet your approval, we'll adopt those. Is there such a motion?

DR. McGEE: So move.

MR. JONES: Second.

THE CHAIRMAN: Motion made and seconded. All in favor say aye.

(Board members in favor of the motion so indicated.)

THE CHAIRMAN: All opposed nay. Motion carries.

One other item of business. With Willie Huff's term expiring, we will need a replacement member of the Investment Committee. I'd like to recommend or ask Mr. Buffkin if he would honor us with that responsibility and serve on the Investment Committee for the Board.

MR. BUFFKIN: I look forward to participating.

THE CHAIRMAN: I've never been so thankful to get to work with colleagues like are around this table and staff to support this worthy program and our worthy counselors and advisors. I am truly grateful. It's truly special to be a part of a program that impacts the lives and families and the growth of this state.

Any more business before the Board? Is there a motion that we adjourn?

MR. SHERLING: So move.

THE CHAIRMAN: So move.

(The proceedings concluded at 12:43 p.m.)

Kay Ivey

Chairman Kay Ivey

AGENDA ITEM IV. (A.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on November 30, 2005

Topic: Approval of "Special Building Fee" at Two Year Colleges

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and

WHEREAS, The PACT Program is established whereby purchasers enter into PACT contracts for the future payment of tuition and Qualified Fees at eligible educational institutions as provided in Section 16-33C-6 (a) *Code of Alabama, 1975;* and

WHEREAS, the Board has defined Qualified Fees as those fees approved by the Board which are required as a condition of enrollment for all students attending the Postsecondary Institution in which the Designated Beneficiary is enrolled; and

WHEREAS, the Board has received and considered substantial information concerning "Special Building Fees" from Dr. Roy Johnson, Chancellor, Alabama College System and his assistant, Debbie Dahl; now

THEREFORE BE IT RESOLVED, that the "Special Building Fee" at the 2 year colleges shall be, and hereby is, approved as a Qualified Fee and adopted by the Board on behalf of the PACT Program for the 2005-2006 academic year.

AGENDA ITEM IV. (B.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on November 30, 2005

Topic: Adoption of Changes to the Investment Policy

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, the Board has the power to invest as it deems appropriate any funds in the PACT Trust Fund in any instrument, obligation, security, or property that constitutes legal investments for public funds in the state, including legal investments for the State Treasurer and the Alabama Trust Fund; and,

WHEREAS, the Board has the power to establish other policies, procedures, and criteria necessary to implement and administer the provisions of the law; and,

WHEREAS, the Board's Investment Consultant, Callan Associates, has reviewed and revised the 2005 Investment Policy to indicate recommended approval of exceptions to the investment policy as requested by INTECH, LLC; and,

WHEREAS, the Board has considered the recommended exceptions as attached hereto and,

NOW, THEREFORE, BE IT RESOLVED, that the revised Investment Policy and Guidelines Statement dated August 2005, for Domestic Equity Investments Managers in substantially the form presented to the Board shall be, and hereby is, approved and adopted on behalf of the PACT Program.

Agenda Item IV. (C.)

Adopted Resolution by the
PACT Board of Trustees at its meeting on November 30, 2006

Topic: Request for Proposals for Domestic Large Cap Equity Value Manager

WHEREAS, the procurement of professional service providers is subject to the requirements of Section 41-16-72(4), Code of Alabama (1975); and

WHEREAS, the Board of Trustees has approved an asset allocation that includes large cap domestic equity value management; and

WHEREAS, the Board reserves the right to select one or more large cap domestic equity value investment managers through a competitive selection process ; and

WHEREAS, the Board desires to proceed with the selection process ; Now

THEREFORE, BE IT RESOLVED that the Board authorizes the staff of the Treasurer's Office (1) to distribute a Request for Proposals to all interested entities as determined by State Purchasing and by the PACT Program and Consultant and (2) to provide access to the proposal on the Treasurer's website

BE IT FURTHER RESOLVED that the Investment Consultant to the Board is directed and authorized to evaluate all responses to the Request for Proposals and provide its evaluations and recommendations to the Investment Committee. The Investment Committee shall discuss and review the information provided so that such entities that present with initial merit, qualifications, experience and ability to best meet the needs of the PACT Program as expressed in the request for proposals can be selected and invited to appear and make individual presentations to the Board at a designated time when the Board is convened with a quorum present.

AGENDA ITEM IV. (D.)

Adopted Resolution by the PACT Board of Trustees at its meeting on November 30, 2005

Topic: 2005 PACT Trust Fund Valuation

WHEREAS, the Legislature has created the Wallace-Folsom College Savings Investment Plan (the "Plan") pursuant to Title 16, Chapter 33C of the *Code of Alabama*, 1975 (the "Act"); and,

WHEREAS, the Board of Trustees ("Board") is created and charged with the oversight of the PACT Trust Fund by Section 16-33C-4, with powers enumerated in Section 16-33C-5(1)-(12); and,

WHEREAS, as a part of oversight the Board of Trustees is responsible for approval of the actuarial assumptions used in the annual fiscal year end valuation of the trust fund; and,

WHEREAS, Robert B. Crompton, Actuarial Resources Corporation, the actuarial consultant, has provided his recommendations, assumptions and advices to the Board, and the Board had substantial discussion and consideration thereof; Now

THEREFORE, BE IT RESOLVED, that the Board adopts the following assumptions to be used in the September 30, 2005 trust fund valuation:

Investment Return: Next five years: 7.88%; 8.5% thereafter

Tuition Increases: 7.25%

Number of Hours of Tuition Benefits Used: 128

Enrollment of PACT Beneficiaries: 82.5% for four-year universities; and 17.5% for junior colleges

Bias: 5%

Contract Cancellations:

(Year 0 = year of purchase)	**Lump Sum**	**5-Year**	**Extended**
Year 0	0.5%	5.0%	6.0%
Year 1	0.5%	2.0%	5.0%
Year 2	0.5%	1.0%	4.0%
Year 3	0.5%	1.0%	4.0%
Year 4	0.5%	1.0%	3.0%
Year 5 and later	0.5%	1.0%	2.0%

Payment of Tuition and Qualified Fees:

- Fall – Nov. 1
- Spring – March 1
- Summer – August 1
- 45% Fall, 45% Spring, 10% Summer

Death and Disability: none